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Comments On Employee Plans Compliance Resolution System

Comments to the Department of the Treasury, Internal Revenue Service
Rev. Proc. 2003-44
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The American Society of Pension Actuaries (ASPPA) submits the following comments regarding the Employee Plans Compliance Resolution System (EPCRS), as currently described in Revenue Procedure ("Rev. Proc.") 2003-44.

ASPPA is a national organization of more than 5,000 members who provide actuarial, consulting, administrative, legal and other services to qualified plans and tax-sheltered annuities.

Summary of Issues

These comments address the recommendations listed below and are described in greater detail in the "Discussion of Recommendations" section. Each recommendation begins with a general statement of ASPPA's proposal, and is followed by a detailed discussion of (i) the proposed change to EPCRS, (ii) the rationale for the change, and (iii) the expected benefits thereof to plan sponsors and the Service. In summary, ASPPA recommends that the Tax Exempt and Government Entities Division ("TE/GE"):

1. Adopt a notice filing program for reporting and correcting failures in qualified plans.
2. Modify the Self-Correction Program (SCP) to extend the significant defect correction period from two to three years.
3. Expand its procedures to provide for voluntary correction of prohibited transactions and coordination with the VFC Program.
4. Adopt procedures to address restorative payments.

Introduction

ASPPA finds that a substantial and steadily increasing number of qualified retirement plan sponsors are opting to forgo voluntary correction with Service approval (VCP) of qualification failures occurring in their plans. Although many plan sponsors decide to correct failures on an unsupervised basis, there continues to be significant noncompliance with the qualified plan rules.

The increase in the number of plan sponsors electing to forgo VCP correction strongly appears to be due to their perception that the cost and time necessary to resolve qualification failures under VCP outweigh the program's benefits. Thus, plan sponsors are becoming more willing to accept the risk of a sanction under the Audit Closing Agreement Program (Audit CAP) or even plan disqualification.

ASPPA's concerns regarding the declining use of VCP are not being assuaged by any perceived increase in the use of self-correction under the Self-Correction Program (SCP). This is because there is currently no reliable information

available to properly evaluate SCP's use and effectiveness. In this regard, ASPPA notes a September 12, 2003, report issued by the Treasury Inspector General for Tax Administration. This report found that TE/GE has not established clear and measurable goals for EPCRS, which makes it difficult for TE/GE to evaluate the extent to which the system is being used and/or how successful it has been in promoting compliance. Therefore, it is unclear to ASPPA whether the use of SCP is on the increase and, if it is, whether it is being implemented correctly.

For these reasons, ASPPA recommends that TE/GE implement under EPCRS a pilot notice filing program (the "Program"; recommendation 1) as soon as reasonably feasible. Under the Program, plan sponsors could report and correct operational and demographic failures occurring in their qualified plans, 403(b) plans, SEPs, and SIMPLE IRA plans without having to prepare a formal (and often lengthy) application or paying a filing fee. As explained in the following section, the Program would not be a replacement for VCP or SCP.

The purpose of the Program would be to:

- Encourage a substantial increase in measurable correction (including the ability to track the level and type of corrective activity, and the size and type of the plans and plan sponsors involved);
- Significantly reduce the cost of correction and, thus, make EPCRS more affordable to employers of all sizes; and
- Enable TE/GE to conserve its limited resources, by putting it in a position where more of its workforce can be directed at working only those cases worthy of individual review.

In addition to the Program, ASPPA recommends that the following changes be made to EPCRS to make it more useful and effective:

2. Extend the significant defect correction period under SCP from two to three years;
3. Expand the procedures to provide for voluntary correction of prohibited transactions and coordination of tax correction of these transactions with resolution of fiduciary-related concerns under the DOL's Voluntary Fiduciary Correction ("VFC") Program; and
4. Expand the procedures to include rulings on restorative payments.

Discussion of Recommendations

1. Recommendation: TE/GE Adopt a Notice Filing Program for Reporting and Correcting Operational and Demographic Failures in Qualified Plans, 403(b) Plans, SEPs, and SIMPLE IRA Plans.

The purpose and focus of the Program would be to provide an expedited procedure for correcting significant operational failures that are ineligible for correction under SCP, but are so common and recurring in nature that the correction method is well settled and, thus, the expense and time associated with IRS-supervised correction are not warranted. In addition, the Program would be available to correct all demographic failures.

Under the Program, plan sponsors should have the option of using an individually designed notice or an IRS-approved form (the "Notice"). The Notice should be relatively short and briefly address the following issues:

- Identification of the failure(s);
- Identification of the year(s) involved;
- The number of current and/or former participants affected;
- A description of the administrative procedures in effect at the time the failure occurred;
- An explanation of how and why the failure occurred;
- A description of the actual method of correction, if the correction has been performed as of the date of the notice, or the proposed method of correction;
- The expected cost of correction;
- A general description of the methodology used to calculate any required earnings adjustment; and

- A description of the administrative measures that have or will be implemented to ensure the same failure will not recur.

There should be no filing fee associated with the Program.

Plans submitted under the Program should be subject to full VCP-level review if the facts and circumstances of the case indicate that a more in-depth review is necessary to ensure compliance with EPCRS. Furthermore, cases submitted under the Program should be subject to random sampling for an in-depth review, as necessary to ensure the integrity of the Program and EPCRS.

Upon receipt of the Notice, the Service should respond quickly with an acknowledgement of receipt. The acknowledgement should inform the plan sponsor that, unless the Service indicates otherwise within a specified time period (e.g., 90 or 120 days), the plan sponsor has "reliance"—as currently contemplated by Section 3.06 of Rev. Proc. 2003-44—that the defect submitted was eligible for correction under EPCRS, and that the proposed method of correction is acceptable. The acknowledgement should also inform the plan sponsor of the time it has to complete all actions necessary to implement the proposed method of correction (e.g., 150 days, measured from the postmark date).

Unless the case is sampled for in-depth review and related inquiry, there would be no further correspondence between the Service and the plan sponsor.

As an initial matter, it may be prudent to limit the operational failures eligible for correction under the Program to those specified in Appendices A and B of the EPCRS revenue procedure. After the Service and plan sponsors become more comfortable with the Program and confident that it is being used properly and effectively, the Service should expand the type of operational failures eligible for correction under the Program. (As indicated above, all demographic failures would be eligible for correction under the Program.)

The Program should provide that, even if an operational failure is eligible for correction under SCP, the plan sponsor may elect to resolve the failure under the Program. This is because some plan sponsors may want or need evidence that they notified the Service of an operational failure and corrected it in accordance with EPCRS. This may be true, for example, in the case of a merger or acquisition, where the plan's qualified status is an issue in the due diligence process. Another example would be the case of an IRS audit, where a plan sponsor may find it advantageous to have documentation to establish to a Revenue Agent that certain failures have been reported to the Service and properly corrected under EPCRS.

The Service would also benefit by permitting plan sponsors to use the Program for failures eligible for correction under SCP. This is because the Program would provide the Service with an opportunity to capture information that is currently unobtainable under SCP. In addition, information collected as part of the Program may put the Service in a position to make certain assumptions about correction under SCP and, thus, measure its success on a stand-alone basis and/or as compared to VCP.

In addition to assisting the Service with assessing the use and effectiveness of SCP, the Program will also provide the Service with the opportunity to do the following:

- Review those cases where it believes additional analysis and/or inquiry is warranted;
- Sample a representative number of cases in desired categories to determine the level of compliance with the Internal Revenue Code and/or EPCRS;
- Collect statistical data to enable it to measure or otherwise evaluate the use and success of EPCRS, and whether its goals are being achieved
- Determine whether the underlying principles of EPCRS are being achieved in the most effective manner

Simply put, the key advantage of the Program is that it permits self-correction with the government's knowledge, which addresses the time and cost issues that are so important to plan sponsors. Additionally, at the same time, it addresses the government's need to monitor and measure EPCRS, and appropriately

allocate its limited resources.

2. Recommendation: TE/GE Modify the Self-Correction Program to Extend The Correction Period for Significant Defects from Two to Three Years.

ASPPA recommends that the two-year self-correction period for significant operational failures under SCP be extended to three years. A three-year correction period bears a logical relationship to the plan years open to the Service for audit under the statute of limitations. If the correction period were extended to match the statute of limitations period, plan sponsors would be encouraged to conduct self-audits of their plans for the entire period open under the statute of limitations and self-correct the operational defects discovered during that process. This would necessarily reduce the number of Audit CAP cases and, at the same time, free up resources for the Service's audit function.

In the experience of ASPPA's members, the current two-year correction period under SCP encourages many plan sponsors to limit their self-audits to the two most recent plans years. This is especially true for small plan sponsors, because they often believe they cannot afford to become aware of failures that might obligate them to incur the costs of a formal IRS application and significant Compliance Correction Fee. Extending the significant defect self-correction period under SCP to three years would address these concerns, encouraging more extensive use of self-audits and, thus further promoting voluntary compliance. This, in turn, would relieve some of the burden on the Service's examination and Audit CAP functions.

3. Recommendation: TE/GE Expand Its Procedures to Provide for Voluntary Correction of Prohibited Transactions And Coordination with The VFC Program.

It is ASPPA's understanding that the Service is continuing to explore the possibility of expanding EPCRS to include a procedure for the voluntary correction of prohibited transactions (PTs). Of course, to be truly effective, the procedure would have to include coordination with the Department of Labor ("DOL"). ASPPA strongly supports such a procedure.

At one time, many of ASPPA's members who practiced in the Pacific Coast Area were able to assist their clients in resolving the tax ramifications of PTs by voluntarily submitting them under the previously available Delegation Order 97 ("DO 97") program. That program required complete correction of the PT. The correction was memorialized in a closing agreement, which also waived the related penalties, interest, and Form 5330 filing requirements. In exchange for the agreement, the plan sponsor, or a responsible fiduciary, paid a sanction to the Service equal to 75% of the excise taxes that otherwise would have been due.

Without question, the DO 97 program was enormously effective in encouraging voluntary correction in cases where prohibited transaction problems otherwise would have gone unaddressed. The main problem with the prior DO 97 program was that the fixed sanction percentage could result in a penalty amount sufficiently expensive to discourage plan sponsors from taking advantage of the program. Therefore, any voluntary program for resolving PTs should be structured to encourage compliance through limited fees, which could be negotiated taking into account the facts and circumstances of the particular case.

In addition, all fiduciary breaches resolved under the Voluntary Fiduciary Correction (VFC) Program, which are also PTs under Code Section 4975, should be "deemed" corrected when calculating the related excise taxes. Therefore, the taxable period for excise tax purposes should end no later than the date of correction for VFC purposes. In the rare case in which Title II of ERISA would require correction different from what is required under VFC, such correction—if made within a reasonable period of time measured from the date of the DOL "no action" letter—should not result in any extension of the taxable period under the excise tax provisions. Of course, this will require significant coordination with the DOL; however, the incentive this will provide to plan sponsors and fiduciaries to correct PTs on a voluntary basis will undoubtedly be well worth the IRS's and the DOL's efforts.

4. Recommendation: TE/GE Adopt Procedures to Address Restorative Payments

To avoid the cumbersome and time-consuming process of obtaining a Private Letter Ruling, ASPPA continues to encourage the Service to expand the procedures under EPCRS to specifically address the issue of whether an employer contribution to correct a qualification failure is a restorative payment. This issue arises when a plan sponsor makes a deposit to a plan in order to address actual or threatened litigation, and the contribution is allocated to participant accounts on a basis other than as required by the plan's written terms for contributions. The failure to allocate the deposit as a contribution results in an operational failure, unless the deposit is a restorative payment. Plan sponsors need an efficient procedure upon which then can rely in determining whether a corrective deposit is an employer contribution or a restorative payment.

Accordingly, ASPPA proposes that EPCRS be expanded to assist the plan sponsor in differentiating a contribution and a restorative payment. Besides providing guidelines for this differentiation, the program could provide for a notice or certification procedure, in which the plan sponsor describes the purpose of the employer deposit, the manner in which it was allocated to participant accounts, and how it meets established guidelines for restorative payments. The notice or certification could either be attached to an information report (e.g., a Form 5500) or simply kept available in the plan's records in the event the Service later examines the plan.

Conclusion

The IRS-supervised correction under EPCRS is becoming less popular with plan sponsors due to its high cost and the substantial length of time it takes to complete the process. To address this, ASPPA recommends that TE/GE adopt a notice filing procedure as described above. This procedure—with its simplified, no-cost application, faster turnaround time and degree of reliance equal to what can be achieved under VCP or SCP—will likely encourage the increased use of EPCRS and, thus, voluntary compliance in general. In addition, it will allow the Service to better allocate its limited resources and gather valuable information regarding the use and effectiveness of EPCRS.

ASPPA also recommends that the Service improve EPCRS by expanding its procedures to (i) extend the self-correction period under SCP, (ii) provide for voluntary correction of prohibited transactions in coordination with VFC, and (iii) address restorative payments.

The changes proposed herein would undoubtedly have the effect of increasing the EPCRS's popularity and, thus, its use, which would necessarily promote voluntary compliance with the qualified plan rules.

ASPPA appreciates the productive meeting it had in June 2003 with Joyce Kahn and members of her staff, and would welcome the opportunity to work with them on the details of what has been proposed in this letter and any other developments in the EPCRS area in the future.

This letter was prepared by ASPPA's IRS Subcommittee of the Government Affairs Committee. Please contact us if you have any comments or questions regarding the matters discussed above.

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