4245 North Fairfax Drive, Suite 750
Arlington, VA 22203
P 703.516.9300 F 703.516.9308
www.asppa.org

April 25, 2008

W. Thomas Reeder
Benefits Tax Counsel
Office of Tax Policy
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

William Bortz
Associate Benefits Tax Counsel
Office of Tax Policy
Department of the Treasury
1500 Pennsylvania Avenue, NE
Washington, DC 20220

Dear Tom and Bill:

The American Society of Pension Professionals & Actuaries (ASPPA) is writing to follow up on our February 26th, 2008, meeting with Internal Revenue Service (IRS) and Treasury representatives in which we discussed methods available to plan sponsors to retroactively correct certain document errors currently provided through the Employee Plans Compliance Resolution System (EPCRS). This letter describes the EPCRS provisions that apply to retroactive plan amendments, along with the factors that we understand are applied by the Service in reviewing requests for approval of retroactive plan amendments to correct "inadvertent" document drafting errors. We then provide suggestions for additional examples that may assist plan sponsors and practitioners in determining when correction by retroactive amendment may be appropriate.

ASPPA is a national organization of more than 6,000 retirement professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA members are retirement professionals of all disciplines, including consultants, investment professionals, administrators, actuaries, accountants and attorneys. Our large and broad-based membership gives ASPPA unique insight into practical applications of ERISA and qualified retirement plans, with a particular focus on the issues faced by small- to mid-sized employers. ASPPA's membership is diverse but united by a common dedication to the employer-sponsored retirement plan system.

Current EPCRS Provisions

Section 4.05 of EPCRS (Revenue Procedure 2006-27) provides guidelines for correction by plan amendment – with and without IRS approval.

I. Self-correction

Correction through the use of a retroactive plan amendment without IRS approval is limited to the following four operational failures (*i.e.,* failures to follow the terms of the plan):

- Compensation Limit: A retroactive plan amendment is permitted to make an additional allocation to non-HCEs where the plan took into account compensation in excess of the Code Section 401(a)(17) limit.

- Hardships: A retroactive plan amendment is permitted to allow hardship distributions where the plan made one or more hardship distributions but the plan document did not provide for such distributions.

- Loans: A retroactive plan amendment to allow plan loans is permitted where the plan permitted one or more participants to take a loan but the plan document did not permit such loans.

- Early Inclusion: A retroactive plan amendment to allow early inclusion of an otherwise eligible employee is permitted where the employee did not meet the age or service requirement under the plan document but nonetheless was permitted to become a participant on a date earlier than the applicable plan entry date.

The full correction procedures are set forth in Appendix B, 2.07 of EPCRS. Also, it is worth noting that the plan sponsor must submit a determination letter application during its regular cycle in accordance with Revenue Procedure 2007-44, and the retroactive corrective plan amendment must be included in the submission and expressly identified as such in the cover letter to the IRS.

II. Correction with IRS Approval

A plan sponsor can correct a variety of failures with a retroactive plan amendment provided the sponsor obtains IRS approval through EPCRS, either by filing under "VCP" or correction as part of an IRS plan audit through "Audit CAP," as described below:

- Type of Violation: The plan amendment can address any of the following types of violations: (1) plan document violation (*i.e.,* the plan does not comply with the Code terms), (2) demographic failure [*i.e.,* violation of Code Sections 401(a)(4), 401(a)(26) or 410(b)], or (3) operational failure (*i.e.,* failure to follow plan terms). [There are also special procedures (and reduced fees) for failing to adopt amendments necessitated by a statutory change or a change in the requirements provided in regulations or other IRS guidance.]

- Code Restrictions: The plan amendment must comply with the requirements of Code Section 401(a), including Sections 401(a)(4) (nondiscrimination rules), 410(b) (coverage rules) and 411(d)(6) (anti-cutback rules).

- Corrective Action: A plan amendment for an operational failure may be adopted to the extent necessary to reflect the corrective action. For example, if the plan violated the average deferral percentage ("ADP") test and the plan sponsor makes a qualified nonelective contribution ("QNEC") to pass the ADP test but the plan

does not permit such contributions, the plan can be amended retroactively to permit QNECs.

III. Factors That the Service Considers for VCP Approval of Retroactive Plan Correction

Based upon our discussion with you, we understand that the IRS generally considers the following factors in determining whether retroactive plan amendments are permissible:

- Who is Affected: Does the amendment affect HCEs, non-HCEs or both? Generally, an amendment that favors only HCEs or does not equally affect all participants (unless it favors non-HCEs) is unlikely to be approved. Such an amendment may also raise nondiscrimination testing issues.

- Reduction in Accrued Benefits: Does the amendment take away any accrued benefits? The amendment cannot violate Code Section 411(d)(6) and the regulations thereunder. Therefore, if the amendment reduces any protected benefits, it is unlikely to be approved.

- Consistent Operations: Was the operation of the plan consistent for all affected participants, and consistently interpreted over the period of the violation? A variation in operations is not a favorable factor.

- Supporting Documentation: For an operational violation, do extrinsic documents support the argument that there is a mistake in the plan document? One or more extrinsic documents, such as the summary plan description, employee handbook, prior plan document/adoption agreement, specification checklist, union contract, written administrative procedures or other communications should support that the plan language was incorrect.

- Required or Discretionary Amendment: Is the amendment required for plan qualification purposes or is it purely a discretionary amendment? It is a favorable factor if the amendment is required to meet the requirements of Code Section 401(a) rather than a design change.

- Expectations of the Participants: If the amendment is approved, will the plan as amended properly reflect the expectations of the participants, or will it represent a change? If participant communications are consistent with the provisions as amended by the corrective document, it is more likely for the amendment to be approved. Evidence, such as summary plan descriptions or other participant communications, can bolster the argument that the amendment is consistent with participants' expectations.

- Impact of Plan Amendment: Does the amendment create another failure under the plan? It is not a favorable factor if correcting with the plan amendment causes another operational violation.

IV. Suggested Examples Where Retroactive Amendments Should Be Permitted Under the Above Guidelines

Here are several examples where we believe that correction by retroactive amendment should be permitted.

1. There is a failure to provide for a certain type of contribution [such as a matching contribution in a 401(k) plan], notwithstanding the fact that such contributions have been deposited by the employer and allocated to participants' accounts.

   Example #1: Missing Matching Provision. A 401(k) plan adoption agreement provision has not been properly completed to permit discretionary matching contributions. Nonetheless, the plan sponsor has made non-discriminatory matching contributions on behalf of the participants and has allocated such matching contributions to the participants' accounts.

   Application of above criteria:

   - The matching contributions passed ACP testing each year under Code Section 401(m), and, as such, were nondiscriminatory in nature.
   - The error affects both HCEs and NHCEs.
   - Participants received communications of the matching contribution and made their salary deferrals in reliance on the promise that they would be matched.
   - This error results only in the provision of additional contributions to participants so there is no Code Section 411(d)(6) cutback if the amendment is permitted.
   - The amendment of the plan as proposed would not create another violation of the Code.

2. A plan contains provisions that are internally inconsistent or omits provisions that are clearly required for the documented provisions to make sense.

   Example #2: Vesting Error. A profit sharing plan is drafted to provide for a two-year wait for eligibility purposes. However, the drafter inadvertently failed to provide for 100% vesting.

   Application of above criteria:

   - The participants who were not fully vested under the actual plan document consist significantly of NHCEs. Therefore, the damage that will be done if the plan amendment is not permitted will adversely affect mostly NHCEs.
   - Participants have received statements reflecting 100% vesting and it will be viewed as a "take away" if they are given the vesting under the plan provisions as originally drafted.

- There is no cutback if the amendment is permitted, so Code Section 411(d)(6) is not invoked.
- The amendment as proposed would not create another violation of the Code.

3. The plan document contains terms that are inconsistent with a collective bargaining agreement or corporate transaction document.

Example #3A: Violation of Collective Bargaining Agreement. A retirement plan is drafted to exclude union employees. However, the collective bargaining agreement provides that the employer's plan is to cover the union employees, and such contributions have historically been deposited to the plan. A failure to provide contributions to the union employees will violate the collective bargaining agreement.

Application of above criteria:

- As the error would exclude union employees, *all* affected participants are NHCEs.
- A failure to permit this correction would preclude the ability of the employer to act as promised under the collective bargaining agreement, and would likely lead to a complaint by the union to the NLRB of unfair labor practices by the plan sponsor.
- The employees were parties to the collective bargaining agreement; as such, their expectations are that they were to be covered under the plan.
- A failure to permit this correction would cause NHCE contributions to be returned to participants as taxable, wreaking considerable hardship on the participants.
- The proposed amendment would neither cut back benefits under Code Section 411(d)(6) nor violate another section of the Code.

Example #3B: Inconsistency with Corporate Acquisition Documents. Company A acquires the stock of Company B. Both companies have 401(k) plans with different eligibility requirements and employer matching contributions. The Acquisition Agreement for the corporate transaction provides that the Company B employees will continue to participate in the Company B plan through the transition period under Code Section 410(b)(6)(C) and that Company B employees will not participate in the Company A plan until amendments are adopted for that purpose. However, the Company A plan provides that employees of a controlled group member are eligible to participate. Because Company B became a controlled group member with Company A on the date its stock was acquired, Company B employees are technically eligible to participate in both plans. Consistent with the merger agreement, Company B employees have not been permitted to participate in the Company A plan and have never been provided with information about the plan.

Application of above criteria:

- All of the employees of Company B, both HCEs and NHCEs, are affected by this error, and would be placed in the position that they expected if the amendment was approved.
- A copy of the acquisition documents are being provided as demonstration of the intent of the parties.
- The matching contributions and employer contributions in the Company A plan are not more generous than those in the Company B plan, so the failure to enroll the Company B employees in the Company A plan does not provide a lesser amount of employer contributions to such employees. Furthermore, the modification to the plan to defer enrollment of the Company B employees in the Company A plan would not constitute a cutback of benefits that would be impermissible under Code Section 411(d)(6).
- There would be no additional violation of the Code caused by this amendment.

4. The plan has been administered incorrectly, and the administration is more favorable to nonhighly compensated employees than the documented provision.

Example #4: Vesting Error. The plan sponsor intended that the plan provide for a vesting schedule of 25% per year of service up to four years. The drafter inadvertently documented the plan to provide for a six-year graded vesting schedule. The plan has always been administered based on the 25% per year schedule. Forfeitures reduce employer contributions.

Application of above criteria:

- The majority of employees who are not fully vested under the six-year schedule are NHCEs. Therefore, the proposed amendment would benefit the NHCEs significantly.
- The prior plan provided for the 25% vesting. The change to the six-year graded schedule was an unintended departure from plan practices.
- The participants' statements have reflected the 25% vesting, so this schedule is consistent with their expectations.
- Because forfeitures reduce employer contributions, the faster vesting does not adversely affect the accounts of other participants (*i.e.,* it does not cause a decrement to the amount that is allocable to their accounts each year as it would have if the plan provided for a reallocation of forfeitures).
- The amendment would represent neither a Code Section 411(d)(6) cutback nor a violation of another Code section.

ASPPA Recommendations

ASPPA understands that due to the factors outlined above, the Service is reluctant to expand the types of retroactive plan amendments permitted under self-correction. We believe, however, that many practitioners are not aware of the scope of the Service's willingness to approve corrections by a retroactive plan amendment under VCP and audit CAP. We therefore encourage the Service to publicize situations and factors that the Service considers when permitting retroactive plan amendments to correct inadvertent drafting errors. This can be done either as an article in the Employee Plans Newsletter or by revisions to EPCRS (or both). We believe this will encourage more practitioners to use VCP to correct such errors and, over time, the Service may see a pattern of common situations that would warrant the expansion of the amendments permitted to be made under self-correction.

These comments were prepared by the IRS Subcommittee of the ASPPA Government Affairs Committee and were principally authored by Liz Dold, APM, and Jim Paul, APM, Vice-Chair and Chair, respectively. Please contact us if you have questions or if we can provide further information or clarification. We would welcome the opportunity to meet with you further to discuss these issues. Thank you for your time and consideration.

Sincerely,

/s/
Brian H. Graff, Esq., APM
Executive Director/CEO

/s/
Teresa T. Bloom, Esq., APM
Chief of Government Affairs

/s/
Judy A. Miller, MSPA
Chief of Actuarial Issues

/s/
David M. Lipkin, MSPA
Co-chair, Government Affairs Committee

/s/
Robert M. Richter, Esq., APM
Co-chair, Government Affairs Committee

/s/
Mark L. Lofgren, Esq., APM
Co-chair, Admin. Relations Committee