Revenue Procedure 2000-16 The Employee Plans Compliance Resolution System

September 11, 2000

Ms. Joyce Kahn
Tax Exempt and Government Entities
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Re: Revenue Procedure 2000-16 The Employee Plans Compliance Resolution System

Dear Ms. Kahn:

The American Society of Pension Actuaries (ASPPA) commends the Service on its recent issuance of Revenue Procedure 2000-16 (Rev. Proc.), which consolidates the Service's 1998 and 1999 guidance concerning its Employee Plans Compliance Resolution System (EPCRS). As you know, ASPPA is a national organization of approximately 3,700 members who provide actuarial, consulting, administration, legal and other professional services for qualified plans and tax-sheltered annuities. ASPPA's members and their clients are committed to compliance with the legal requirements affecting these plans and arrangements. Since the Service has indicated that it is actively reviewing comments on EPCRS and plans to update the Rev. Proc. on an annual basis, we offer these comments on ways we believe EPCRS and the Rev. Proc. can be improved.

SUMMARY OF ISSUES

This letter addresses a broad range of issues, which are described in greater detail below. We begin with our general comments and proceed to our more specific comments, as follows:

1. Expansion of EPCRS to address problems with Simplified Employee Pension plans (SEPs);

2. Processing timeframes and status conferences with respect to the Voluntary Compliance Resolution (VCR) Program, the Tax Sheltered Annuity Voluntary Correction (TVC) Program and the Walk-in Closing Agreement Program (Walk-in CAP);

3. Clarification of the availability of VCR, TVC and Walk-in CAP in connection with mergers and acquisitions;

4. Extension of VCR program to practitioners, such as certified pension consultants, who are qualified to submit applications to Walk-in CAP and represent plan sponsors on audit (e.g., unenrolled preparers).

5. Clarification of the tax treatment of corrective contributions and distributions;

6. A review and/or appeals mechanism for APRSC/audit CAP;

7. Combination of VCR and Walk-in CAP;

8. Extension of the concept of an "eligibility failure" to qualified plans of an ineligible employer;

9. Modification of existing optional methods for determining lost earnings;

10. Inadvertent inclusion of ineligible participants;

11. Inadvertent contributions or deposits to a qualified plan;

12. Identification of operational failures not requiring further correction;

13. A consistent "John Doe" Walk-in CAP;

14. Clarification that Walk-in CAP is available for GUST nonamenders; and

15. Extending Reformation CAP and making SVP available to correct certain "scrivener's errors."

DISCUSSION OF ISSUES

1. Expansion of EPCRS to address problems with Simplified Employee Pension plans (SEPs).

Since our members routinely deal with small and medium-sized businesses, ASPPA recommends that the Service expand EPCRS to address compliance issues with respect to SEPs and SARSEPs. Due to the relative lack of sophistication of employers establishing these arrangements and the lack of guidance from providers, we believe that there is a fairly significant level of noncompliance among these plans. Accordingly, ASPPA believes voluntary correction options under EPCRS should be extended to sponsors of SEPs and SARSEPs.

2. Processing timeframes and status conferences with respect to the Voluntary Compliance Resolution (VCR) Program, the Tax Sheltered Annuity Voluntary Correction Program (TVC) and the Walk-in Closing Agreement Program (Walk-in CAP).

Many of ASPPA's members are involved with assisting qualified plan and 403(b) plan sponsors with making VCR, TVC and Walk-in CAP submissions. A common complaint we have received from members is that the Rev. Proc. and the operation of VCR, TVC and Walk-in CAP do not specifically provide outside timeframes for the processing of the submissions and do not provide opportunities to discuss the status of a pending submission. It is not uncommon for Walk-in CAP, TVC and VCR submissions to be pending for over a year and a half. Frequently, our members advise their plan sponsor clients to delay the termination or modification of an employee benefit program pending the resolution of a VCR or TVC submission or a Walk-in CAP submission. It is important for clients, plan sponsors and the Service to have clear understandings and expectations with regard to the timeframes for processing these submissions, as well as an opportunity to discuss the status of a pending submission. Therefore, ASPPA recommends that the Service incorporate into the Rev. Proc. outside timeframes for the processing of VCR, TVC and Walk-in CAP submissions as well as the opportunity for, and perhaps specific rights to, a status conference (perhaps similar to those contained in Rev. Proc. 2000-6, section 6.19).

Some of our members also have had difficulties in connection with the initial processing of VCR, TVC and Walk-in CAP submissions. The submission of detailed descriptions of operational failures for all affected years and detailed descriptions of correction methods for such failures often involves collecting extensive employee census and prior plan testing data. As a result, the plan sponsor (employer) may need to obtain testing data and records from a former pension consultant or third party administrator. Oftentimes, due to the lack of retention of records by a plan sponsor (employer), it becomes very difficult to obtain such data which may be six or more years old. In this regard, we request that the Service clarify the provisions of Section 10.05(5) of the Rev. Proc. Under paragraph (5), if, during the initial processing of the VCR submission, additional information is required,

". . . a Service representative will generally contact the Plan sponsor or the Plan sponsor's representative and explain what is needed to complete the submission. The Plan sponsor will have 21 calendar days from the date of this contact to provide the requested information. If the information is not received within 21 days, the matter will be closed, the compliance fee will not be returned, and the case may be referred to Employee Plans Examinations in accordance with Section 10.05(3). Any request for an extension of the 21-day time period must be made in writing within the 21-day time period and must be approved by the Service."

For the reasons mentioned above, ASPPA requests clarification with regard to this timeframe and the ability to obtain an extension. First, we believe the 21 day time period is unrealistically short and should be extended to 60 days. Second, we would like clarification as to whether the current 21 calendar day period runs from the date of the Service's letter or from the date of receipt of such letter. The Rev. Proc. currently refers to the "date of this contact." This distinction can make a considerable difference in certain instances.

Along the same lines, it is not clear from the Rev. Proc. who at the Service has the discretion or authority to grant an extension of the 21-day time period. If this discretion is vested in the Service employee doing the initial processing, we suggest that this discretion be shared with that employee's supervisor and that a right of

conference with the processor's supervisor be available under the Rev. Proc. It is our understanding that a conference right (see Rev. Proc. Section 10.08) only exists "if the Service initially determined that it cannot issue a compliance statement because the parties cannot agree upon correction or a change in administrative procedures, …" As indicated above, we also believe that in some instances, the inability of a plan sponsor to provide requested information in connection with a VCR submission within the time requirements of the Rev. Proc. is also deserving of a conference right.

3. Clarification of the availability of VCR, TVC and Walk-in CAP in connection with mergers and acquisitions.

Occasionally, our members will advise a plan sponsor which is involved in a merger or acquisition transaction. Quite frequently, the parties to such a transaction perform considerable due diligence regarding the operational and document compliance of the target entity's qualified plans. Not infrequently, the parties discover one or more operational or document failures with respect to the target's qualified plan(s) during the due diligence process and the parties would like to submit the affected plan to VCR, TVC or Walk-in CAP for correction. In some instances, the qualified plans of the acquiring entity are already under an Employee Plans examination and the terms of such examination extend to all members of the acquiring entity's controlled group. It appears that once a stock acquisition or merger occurs, the plans of the target entity would automatically come within the scope of such an ongoing examination and would therefore not be eligible under either VCR or Walk-in CAP. Since the operational failure or document failure occurred during a period while the target plans were not part of the acquiring entity's controlled group, it does not seem appropriate to preclude such plans from coming into VCR or Walk-in CAP. We believe the Service should provide an exception or clarification of this with respect to the concept of "under examination."

4. Extension of VCR program to practitioners, such as certified pension consultants, who are qualified to submit applications to Walk-in CAP and represent plan sponsors on audit (e.g., unenrolled preparers).

ASPPA supports the acceptance of VCR applications submitted by certified pension consultants and other professionals who are qualified to advise plan sponsors about the availability of, and prepare applications for, the VCR program. These are practitioners who are authorized to represent their clients in an IRS audit or to submit a case through the Walk-in CAP program, but are considered unenrolled preparers for purposes of Form 2848. ASPPA believes this will increase the support and use of the VCR program which serves as a useful tool in education of plan sponsors and practitioners.

5. Clarification of the tax treatment of corrective contributions and distributions.

Currently, the Rev. Proc. does not address the tax treatment of corrective contributions and distributions made under EPCRS. ASPPA believes guidance in this area is essential because many plan sponsors are making corrective contributions and distributions under EPCRS without a clear understanding of the proper tax treatment of these corrections. Issues which deserve guidance or clarification include:

- Confirmation that the portion of a corrective payment to a plan which is intended to make up for lost earnings is not an "annual addition" for purposes of Code sections 404 and 415 and that such a payment is deductible under Code section 162.

- Confirmation that any corrective contribution and the resulting allocations to participants' accounts should be deductible by the employer in the year of the actual corrective contribution and that such a corrective contribution will not be treated as an annual addition for the year of the actual corrective contribution.

- Clarification of the tax treatment of amounts HCEs are permitted currently to contribute to a 401(k) plan as a result of previously distributed excess contributions that were due to incorrect ADP/ACP testing.

6. A review and/or appeals mechanism for APRSC/audit CAP.

As currently set forth in the Rev. Proc., EPCRS appears to be based on the assumption that Revenue Agents will consistently and correctly apply the relevant procedures and standards in every case. However, the reality is that from time to time Revenue Agents will apply EPCRS inconsistently or incorrectly. In cases where Revenue

Agents mis-apply EPCRS, there exists a potential for unjustified, material and judgmental effects on qualified plans, plan sponsors and participants.

For example, if a plan is under audit and the Revenue Agent incorrectly determines that an operational failure is *egregious*, the plan sponsor loses the ability to resolve that failure under APRSC or VCR and, therefore, must negotiate the payment of a sanction under audit CAP to keep the plan qualified. A similar example is where a Revenue Agent incorrectly determines that an operational failure is *significant,* rather than *insignificant*. Unless the failure was properly corrected by the last day of the second plan year following the plan year for which the failure occurred (or the correction was substantially completed as of the date the plan came under audit), the plan sponsor must again negotiate and pay a sanction under audit CAP rather than utilizing APRSC to maintain the plan's qualified status. Another example involves the misapplication of EPCRS where a Revenue Agent (or possibly the CAP Coordinator) fails to consider or give the proper weight to relevant factors in determining an appropriate sanction under audit CAP, thus increasing the amount that the plan sponsor is required to pay to secure a Closing Agreement. A final example is a Walk-in CAP case where a Revenue Agent (or the Walk-in CAP Coordinator) *unreasonably* (based on the facts and circumstances of the case) rejects a plan sponsor's request to correct an operational failure by retroactively amending the plan to conform its terms to its prior operation (i.e., utilizing "reformation" CAP).

For EPRSC to be effective to the maximum degree, it must be administered on a consistent and uniform basis, and its procedures must be applied properly. For these reasons, ASPPA suggests that the Service establish a formal review and appeals process to ensure consistency and uniformity in the application of EPCRS, and to resolve differences between plan sponsors and EP/EO personnel concerning various correction programs and procedures. Although ASPPA has developed specific and detailed suggestions regarding possible methods of implementing such a review and appeals process, we believe this input would be most useful to the Service after the Service has completed its pending restructuring and reorganization.

7. Combination of VCR and Walk-in CAP.

We understand that the Service has decided to combine VCR and Walk-in CAP. ASPPA and its members are supportive of this combination since this would provide greater flexibility for plan sponsors to identify and correct all of their operational failures without concern about eligibility for one correction program or another. Furthermore, many of our members and their clients have found that because operational failures can be corrected in more than one fashion, it is often useful to "move" from a VCR method of correction into a method of correction which is appropriate only under Walk-in CAP. Presumably, the combination of the two programs would also allow the Service to concentrate its resources both in terms of personnel available to process the cases as well as personnel available to supervise the cases.

8. Extension of the concept of an "eligibility failure" to qualified plans of an ineligible employer.

ASPPA commends the Service's practical approach to the problem of Code section 403(b) plans which have been established by an employer not eligible to maintain such a plan. ASPPA suggests that the method of correction of a plan of an ineligible employer under Rev. Proc. Section 6.02(7) be expanded to also include 401(k) plans that were adopted by ineligible tax-exempt employers between 1986 and 1997 as well as 401(k) plans adopted by governmental employers after 1986. ASPPA believes that ineligible employers of a 401(k) plan are entitled to the same treatment as ineligible employers who have adopted a 403(b) plan under similar circumstances (i.e., generally in these circumstances, these plans have been sold to an employer by a vendor who has no awareness of these limitations.)

9. Modification of existing optional methods for determining lost earnings.

ASPPA commends the Service for providing practical alternatives for determining earnings adjustments under plans that permit directed investments. Although ASPPA's members appreciate the ability to use "the highest rate earned in the plan" pursuant to Rev. Proc. section 6.02(5)(a), we believe that the Service should place an overall cap on the rate of earnings that must be credited to a participant's account when using this method. In light of the broad availability of investment funds in many plans and the extraordinarily high rates of return on certain of these funds, we believe that crediting "the highest rate earned in the plan" in all such cases simply provides a windfall to certain participants while it can and does discourage some sponsors from making any correction at all. For example, one of our members determined that the highest rate earned for a client's plan was 3000% over a two-year period. We suggest that this rule be modified to place some reasonable cap (e.g., a rate equal to the

underpayment rate defined in section 6621(a)(2) of the Internal Revenue Code, plus three percent) on this widely used method of determining lost earnings. Such a cap would provide more realistic and more fair results to all participants in a plan.

The Service should also consider the use of more simple earnings calculation methods, including ones which do not require the sponsor or its advisors to gather significant amounts of detailed, up-to-the-minute financial data. Along these lines, ASPPA suggests that defined contribution plans be given the option of calculating the rate of earnings for a plan year based upon a reasonable estimate of the rate of earnings for the previous plan year. Specifically, it would facilitate and expedite the calculation and making of restorative earnings allocations if sponsors could use the same method of determining earnings set forth for line 6i to Schedule B of Form 5500.

10. Inadvertent inclusion of ineligible participants

ASPPA recommends that the Service provide additional guidance with respect to available correction methods for inadvertent inclusion in a qualified plan of an ineligible participant. In this regard, the Service could in a manner consistent with individual guidance provided to plan sponsors under APRSC, VCR, TVC and Walk-in CAP offer two alternative methods for correcting such a failure.

First, the Service could allow plan sponsors under either APRSC (if appropriate) or under TVC or VCR to remove the ineligible participants and their improperly allocated contributions or accrued benefits from the plan. For this alternative, guidance should include a mechanism for distributing contributions allocated to ineligible persons to the affected individuals or returning such contributions to the sponsor.

Alternatively, the Service could provide guidance indicating the circumstances under which plan sponsors would be allowed to apply under Walk-in CAP for permission to retroactively amend their plan document (e.g., for cases after the 9-1/2 months after the plan year end already permitted under Treasury regulation §1.401(a)(4)-11(g)(3)(iv)) to allow the inclusion of such ineligible participants. Clearly, it would seem appropriate to allow such retroactive amendment and inclusion of inadvertently included ineligible participants in situations where all such participants were NHCEs or where the plan's coverage under Code Section 410(b) would still be met even if the group of ineligible participants consisted of both HCEs and NHCEs.

11. Inadvertent contributions or deposits to a qualified plan.

Although ASPPA's members are fully aware of the general qualification requirement that a plan be operated and administered in accordance with its terms, we occasionally come across situations where, for a variety of reasons, too much money has either been contributed or deposited into a qualified plan. For example, the Plan Administrator or the institutional trustee of a plan, due to a lack of communication, may inadvertently withhold (and deposit into the plan's trust) an additional participant loan payment amount even though the loan has been repaid. Another example would be where the sponsor of a 401(k) plan mistakenly withholds salary deferrals from a participant's payroll even though the participant has requested a change or cessation of that amount of salary deferrals. In other cases, due to simple miscommunications regarding final employee census information and/or plain arithmetic errors, the sponsor of a plan may inadvertently contribute more than the plan's formula requires or allows. Based upon our members' understanding of the rules regarding return of plan assets on account of reversion, failure to initially qualify, or mistake of fact, ASPPA recommends that the Service clarify the ability of sponsors to correct such problems, once identified, under APRSC. If the Service believes that these types of problems cannot be or should not be corrected under APRSC, the Service should provide guidance on this issue.

12. Identification of operational failures not requiring further correction.

On occasion, our members have come across operational failures which, based upon a review of all of the facts and circumstances, do not appear to require further correction. The Service recognizes in section 6.02(6) of the Rev. Proc. that full correction is not required in situations where it is unreasonable or not feasible. It would be helpful for the Service to provide further guidance for situations, where due to the specific circumstances of a particular operational failure, no further correction would or should be required. For example, let us assume that eight years ago an HCE participating in a plan received a participant loan but that the loan (although authorized by the plan document) was not sufficiently documented in accordance with the terms of the plan document, the DOL regulations, or Code section 72(p). Also assume that three years ago, the participant terminated employment and received a complete distribution of her accrued benefit including a distribution of the unpaid

balance on the participant loan. Although the loan was not properly documented in accordance with the plan's requirements, under the circumstances it would appear to us to be unnecessary to require a complete documentation of the loan at this time since the original loan occurred in a closed year with respect to the individual and the loan has subsequently become taxed as a result of the distribution of the participant's entire accrued benefit. Another example might exist where a 401(k) plan has incorrectly conducted its ADP/ACP tests such that certain HCEs received slightly too much in the way of refunded excess contributions in prior years. Although the sponsor could request the HCEs to refund or redeposit the incorrectly distributed excess contributions, in light of the fact that these amounts have already become taxable and the fact that no NHCEs are adversely affected by either the defect or the correction, it seems to us that this also would be an operational failure for which no further correction is required.

13. A consistent "John Doe" Walk-in CAP.

A number of our members practice primarily in what was the Western Region where the Los Angeles Key District Office has for some time been operating a "John Doe" Walk-in CAP. We know that other former key district offices also offered such a program. Those of our members who have considerable experience with VCR and Walk-in CAP feel very strongly that the Service should not only continue the availability of "John Doe" Walk-in CAP but should also expand the program so that it is available on a national basis. Particularly in the case of small and medium-sized plan sponsors, it is important for plan advisers to be able to have the Service consider and address operational failures and suggested methods of correction on an anonymous basis before the plan sponsor is absolutely committed to the Walk-in CAP process.

14. Clarification that Walk-in CAP is available for GUST nonamenders.

Although the Rev. Proc. does not specifically preclude consideration or correction of a so-called "nonamender" due to failure to timely comply with GUST, it is our understanding that there is some confusion within at least one of the former key district offices with respect to whether GUST nonamenders are eligible for correction under Walk-in CAP at this time. We suggest that the Service review this situation and clarify that GUST nonamenders are indeed eligible for Walk-in CAP. An example of such a plan would be a terminated plan which was not timely amended for GUST.

15. Extending Reformation CAP and making SVP available to correct certain "scrivener's errors."

Based upon the ongoing and collective experience of our members, we are convinced that there are a significant number of circumstances under which Reformation CAP (that is the ability to make a retroactive amendment to a plan document to conform its terms to actual plan operation) is an appropriate correction method. Unfortunately, the Walk-in CAP program is a relatively expensive and lengthy process for many small and medium-sized plan sponsors. Since the Service should, by now, have considerably more data on the use of Reformation CAP, ASPPA requests that the Service reconsider our earlier comments and suggestions regarding the expansion and use of such amendments. In this regard, we have included the following excerpt from our letter dated June 1, 1998, which suggests a number of areas and mechanisms by which the Service can approve the utilization of reformative amendments:

Although APRSC currently states that "it is not available to correct violations that can be cured only by plan amendment," we suggest that APRSC be expanded to allow sponsors to use plan amendments to self-correct those operational violations where: (1) additional optional forms of benefits, rights, or features, or the ability to participate have been provided to a group of participants in contravention of the plan document; and (2) the affected group satisfies either the ratio percentage test or one of the other requirements of Reg. §1.410(b)-2(b), other than the average benefit test. For example, in a case where one or more ineligible NHCEs are inadvertently allowed to participate in a plan, it seems appropriate as a matter of policy to allow the plan sponsor to self-correct under APRSC by amending the plan retroactively to permit such participation. Other examples would include situations where a nondiscriminatory group of participants is inadvertently allowed to receive participant loans, hardship distributions or additional vesting in contravention of the plan document. Such an expansion of APRSC would encourage and facilitate the types of self-correction (i.e., providing additional benefits to NHCEs) favored by the Service and, at the same time, would eliminate a significant number of Walk-In CAP submissions for issues which as a matter of policy, do not need to be supervised by the Service. If the Service is not comfortable with permitting these types of plan amendments under APRSC which may benefit HCEs as part of a nondiscriminatory group, the Service should at least consider making such amendments available in cases where only NHCEs are involved.

We recognize the Service's concern that permitting such corrections by amendment may appear to undermine the determination letter program. However, it is our experience that practically all plans, other than standardized prototype plans, are submitted to the Service at some point, including during the extended remedial amendment period. As a result, the Service will eventually have an opportunity to review substantially all of these corrective amendments to make sure that they are eligible corrections made in accordance with APRSC.

If the Service does not feel it is appropriate to allow a plan sponsor to make a retroactive plan amendment in order to self-correct an operational failure, we suggest that the Service consider ways in which it can expand SVP to handle certain limited types of corrections involving retroactive amendments.

Our members have a considerable amount of experience with EPCRS and we believe that EPCRS is a very worthwhile system. However, we agree with the Service that there are ways in which EPCRS can be improved to make it both more accessible to all plan sponsors and more efficient with respect to the utilization of taxpayer and the Service's limited resources. Comments in this letter were prepared by the ASPPA IRS Enforcement Committee, chaired by Jeffrey C. Chang and the ASPPA Tax Exempt And Governmental Plans Committee, chaired by Theresa Lensander, with the assistance of the Government Affairs Committee Co-Chairs and the Government Relations Committee Chair.

Please contact us if you have any comments or questions regarding our comments.

Very truly yours,

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