

# **EPCRS VCP ADVANCED CASE STUDIES: WHEN SELF-CORRECTION ISN'T AN OPTION**

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## **Learning Objectives**

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1. Overview of Procedural Requirements
2. Develop strategies for proposing acceptable and cost-effective corrections and
3. Case Studies

## **What You Will Need**

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1. Form 8950--Application
2. Form 8951—Fee Submission Form
3. Appendix C-Part I (Model Compliance Statement)
4. 2848 or 8821, as appropriate
5. Plan or Relevant Plan Pages
6. Appendix C-Part II (Schedules) as and if applicable

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## **What You Will Need**

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7. Form 8717 and appropriate user fee,
8. If applicable, Determination Letter application and submission documents including copies of documents necessary for both VCP and DL

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## **Not Required But Include**

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Acknowledgement Letter (previously called Appendix D)  
(written acknowledgement that the submission has been received)

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## **Procedural Tips**

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- Remember, 8950 can only be signed by ER (or authorized Board Member in the case of multiemployer plans)
- Sole Proprietor must use an EIN number, not SS# and not Trust EIN
- Make sure to complete items 4d and 4e of Form 8950 (i.e., asset and participant count)

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## **Procedural Tips**

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- If DL required, make sure separate user fee checks are included

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## **Proposing Corrections**

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- Should generally ensure full correction for plan, all participants and for all years whether closed
- Should generally keep assets in the plan or put money in the plan
- Should look like other approved correction methods

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## **Proposing Corrections**

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- Should restore the plan and participants to the position they should have been absent the failure, and
- Should be reasonable, consistent and appropriate

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## **Proposing Correction**

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- Notwithstanding general principles, IRS may show flexibility on correcting HCEs
- IRS tended to show more flexibility in correcting failures to contribute when submitted in early years post-2008 than correcting for same period now

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## **Correcting Complex Failures**

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Ex: Small SIMPLE (IRAs) Plan

- Plan Sponsor never issued contribution notices
- Made 3% match from inception (1998-2008)
- Stops matches from 2009-2014 and advises verbally

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## **Correcting Complex Failures**

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Ex: Small SIMPLE (IRAs) Plan

- ER advises that it will make up match
- EEs gradually stop all elective contributions
- Investment returns post 2010 are significant

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## **Correcting Complex Failures**

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Ex: Small SIMPLE (IRAs) Plan

Problems:

1. Failure to give any notices;
2. No way to “freeze” a SIMPLE IRA;
3. Client first contacts in 2014 well after IRS more “sympathetic” approach to contribution failures

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## **Correcting Complex Failures**

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Ex: Small SIMPLE (IRAs) Plan

Problems:

4. Former wife in bitter divorce one of participants due additional funds

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## **Correcting Complex Failures**

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- What ER Wants:
  1. Stop incurring any more costs for match;
  2. Make EEs whole but limit its cost particularly given the significant rates of investment returns post 2010 and the fact that company has still not fully recovered after 2008

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## **Correcting Complex Failures**

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Small SIMPLE (IRAs) Plan Continued

- Its Now 2014 and ER wants to correct
- What if ER Self Corrects?
  - Are all failures eligible for SCP?
  - Can ER goals be achieved?

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## **Correcting Complex Failures**

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Small SIMPLE (IRAs) Plan Continued

- A SIMPLE can only use Self Correction if:
  1. the failure is Operational and
  2. Insignificant

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## **Correcting Complex Failures**

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Factors weighed in determining whether Insignificant:

1. Existence of other failure
2. % of assets and contributions involved
3. # of years involved;
4. # of affected participants relative to total #;
5. # of affected participants relative to # that could have been affected

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## **Correcting Complex Failures**

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Factors weighed in determining whether Insignificant:

6. How long to correction after discovery, and
7. Reason for the failure

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## **Correcting Complex Failures**

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Small SIMPLE (IRAs) Plan Continued

- Failure to issue Notices as well as late contributions likely Significant and not SCP eligible
- SCP will not allow any flexibility in attempting to limit cost to ER

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## **Correcting Complex Failures**

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### Small SIMPLE (IRAs) Plan Continued

- Given concerns, submit to VCP
- Questions to ask:
  1. What if IRS requires correction client cannot or will not fulfill;
  2. What if IRS will not accept proposal designed to reduce ultimate cost to client

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## **Correcting Complex Failures**

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### Small SIMPLE (IRAs) Plan Continued

- Given concerns, submit to VCP
- Questions to ask:
  3. Do we really have to establish a new account for the former wife?

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## **Correcting Complex Failures**

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Small SIMPLE (IRAs) Plan Continued

- When you are unsure whether the correction you propose will be accepted and you have concerns as to whether your client can and/or will accept a likely proposed correction suggested by IRS, consider benefits and risk of “John Doe.”

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## **Correcting Complex Failures**

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Small SIMPLE (IRAs) Plan Continued

- Greatest risk of an Anonymous submission is the risk that the plan will be pulled for audit before final resolution
- If audited, plan will be unable to continue under Voluntary Correction

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## **Correcting Complex Failures**

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Small SIMPLE (IRAs) Plan Continued

- So all failures submitted John Doe VCP
- Proposed Correction:
  1. Terminate before submission to cut off cost

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## **Correcting Complex Failures**

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Small SIMPLE (IRAs) Plan Continued

- So all failures submitted John Doe VCP
- Proposed Correction:
  2. Make matching contributions, + earnings for all unmatched Elective Contributions other than for the owner

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## **Correcting Complex Failures**

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Small SIMPLE (IRAs) Plan Continued

- So all failures submitted John Doe VCP
- Proposed Correction:
  3. Allow owner to forgo his own match (owner's contribution + earnings was single largest cost);

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## **Correcting Complex Failures**

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Small SIMPLE (IRAs) Plan Continued

- So all failures submitted John Doe VCP
- Proposed Correction:
  4. Payout distribution (rather than establishing an account) for anyone who had already closed out the SIMPLE with the specified brokerage (this would include former wife)

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## **Correcting Complex Failures**

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### Small SIMPLE (IRAs) Plan Continued

5. Argued that Notice failure should be treated as administratively corrected by termination given:

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## **Correcting Complex Failures**

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### Small SIMPLE (IRAs) Plan Continued

- Participants were advised numerous times orally over the 15 year life of the plan as to the plan's existence
- 3% match had remained the level of contribution for that entire 15 year period

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## **Correcting Complex Failures**

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Small SIMPLE (IRAs) Plan Continued

- After providing Financial Statements for the Company, all proposed methods of correction were accepted by the IRS

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## **Correcting Complex Failures**

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Ex: Small 401(k) for Growing Start-Up

- 401(k) Plan adopted from inception of start-up company in 2006
- Sole full-time 50% owner participates
- Other 50% owner starts part-time
- As other owner goes full-time and as others come on full-time, participation never offered

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## **Correcting Complex Failures**

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Ex: Small 401(k) for Growing Start-Up

- Plan uses Prior Year Testing
- Plan provision does not allow match
- Other full-time EEs hired over time, including spouse/owner and children, but none offered participation

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## **Correcting Complex Failures**

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Ex: Small 401(k) for Growing Start-Up

Problems:

1. No real NHCE ADP to use
2. Since only one participant had assets in the Plan and those assets were not really managed, concern about using the very low investment returns for earnings

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## **Correcting Complex Failures**

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Ex: Small 401(k) for Growing Start-Up

What ER Wants

1. Correct for all EEs
2. Avoid an audit

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## **Correcting Complex Failures**

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Ex: Small 401(k) for Growing Start-Up

Plan Proposed correction:

1. QNEC for HCP (spouse and child) = 50% of ADP for sole participating HCE for current year
2. QNEC for NHCEs equal to 50% of the deferral percentage to allow Plan to satisfy ADP test for next year

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## **Correcting Complex Failures**

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Ex: Small 401(k) for Growing Start-Up  
Plan Proposed correction:

3. Earnings using DOL calculator (in this case, DOL calculator earnings were greater than actual plan return for the one actively participating HCE)

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## **Correcting Complex Failures**

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Ex: Safe Harbor 401(k)

- Plan effective in 2005 with 1 YOS
- Restated using a different prototype provider in 2010 with the same provisions including eligibility
- In 2012, the plan moves to its 3<sup>rd</sup> TPA and prototype

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## **Correcting Complex Failures**

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Ex: Safe Harbor 401(k)

- 2012 restatement inadvertently removes service requirement
- No new SPD issued with respect to 2012 restatement

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## **Correcting Complex Failures**

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Ex: Safe Harbor 401(k)

- In 2014, the plan moves to its 4<sup>th</sup> TPA and prototype. At that point, the inadvertent removal of the service requirement for eligibility is discovered

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## **Correcting Complex Failures**

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Ex: Safe Harbor 401(k)

Plan proposes to correct by retroactively amending the plan to reinstate the 1 year eligibility requirement

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## **Correcting Complex Failures**

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Ex: Safe Harbor 401(k)

Plan submits as evidence of intent:

1. The 3 prior plan documents and
2. The prior SPDs

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## **Correcting Complex Failures**

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- Plan argues that no new SPD was issued to accompany the 2012 plan precisely because the intent of the ER was that no substantive changes, including as to eligibility, were to be made in the 2012 restatement.
- Further, that the existing SPDs notified EEs that eligibility was subject to a 1 YOS requirement

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## **Correcting Complex Failures**

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Ex: Mid-Sized 401(k) Of Controlled Group Member

- 3 Brother/Sister Corporations, i.e., A, B & C
- “A” maintains a 401(k) solely for its EEs
- “A” ends up in bankruptcy
- B assumes sponsorship of “A”s 401(k)

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## **Correcting Complex Failures**

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Ex: Mid-Sized 401(k) Of Controlled Group Member

- “B” ultimately collapses 2 years later
- Warehouse fire destroys all payroll records including for participants in “A” plan

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## **Correcting Complex Failures**

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Ex: Mid-Sized 401(k) Of Controlled Group Member

- “C” assumes sponsorship of the “A” plan solely to terminate provided no additional funds are required from C

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## **Correcting Complex Failures**

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Ex: Mid-Sized 401(k) Of Controlled Group Member

- “C” hires advisors to clean up and terminate the “A” Plan
- No ADP/ACP tests have been done for several years
- No payroll records for those missed ADP yrs

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## **Correcting Complex Failures**

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Ex: Mid-Sized 401(k) Of Controlled Group Member

- The “A” Plan has forfeitures that were never allocated
- Attempts to obtain prior payroll records from prior payroll companies and from Social Security all fail

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## **Correcting Complex Failures**

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Ex: Mid-Sized 401(k) Of Controlled Group Member

What ER "C" wants:

1. Terminate the Plan
2. No additional funds from "C"

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## **Correcting Complex Failures**

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Ex: Mid-Sized 401(k) Of Controlled Group Member

Problems:

1. No ADP Tests for several years, and
2. No payroll records that could be used to perform the tests

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## **Correcting Complex Failures**

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Ex: Mid-Sized 401(k) Of Controlled Group Member

Other Failures identified:

1. Adoption Agreement said, for no discernible reason, that among non-Unions, only Managers were eligible; (inconsistent with operation)

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## **Correcting Complex Failures**

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Ex: Mid-Sized 401(k) Of Controlled Group Member

Other Failures identified:

2. Adoption Agreement failed to reflect related entities that were participating in operation
3. No ADP or ACP test done for 2002-2005, and

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## **Correcting Complex Failures**

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Ex: Mid-Sized 401(k) Of Controlled Group Member

Other Failures identified:

4. Plan may have experienced an unrecognized partial termination between 2004-2008

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## **Correcting Complex Failures**

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Ex: Mid-Sized 401(k) Of Controlled Group Member

Corrections Proposed:

1. Retroactively amend to reflect actual categories participating
2. Retroactively amend to reflect actual participation of related entities

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## **Correcting Complex Failures**

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Ex: Mid-Sized 401(k) Of Controlled Group Member

Corrections Proposed For ADP/ACP:

Perform test based upon assumptions:

1. Compensation data was assumed to be the same for missing years as for last year actually available

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## **Correcting Complex Failures**

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Ex: Mid-Sized 401(k) Of Controlled Group Member

Corrections Proposed For ADP/ACP:

Perform test based upon assumptions:

2. If not available for that year, compensation assumed to be average of group, i.e., HCE or NHCE

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## **Correcting Complex Failures**

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Ex: Mid-Sized 401(k) Of Controlled Group Member

Corrections Proposed For ADP/ACP:

Perform test based upon assumptions:

3. Rate of eligible but not participating assumed to be the same as for year actually available

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## **Correcting Complex Failures**

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Ex: Mid-Sized 401(k) Of Controlled Group Member

Corrections Proposed For ADP/ACP:

Perform test based upon assumptions:

4. For the 1 HCE capped in last available year, assume compensation = to each year's cap

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## **Correcting Complex Failures**

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Ex: Mid-Sized 401(k) Of Controlled Group Member

Corrections Proposed For Partial Termination:

Fully vest terminated participants including any accounts transferred to Company “C”

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## **Correcting Complex Failures**

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Ex: ESOP with Many Over 70 ½

- ER maintains 2 DC plans
- Intent was for both to be amended to provide RMD of 70 ½ or retirement, if later for non-5% owners
- One plan was amended—the ESOP was not

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## **Correcting Complex Failures**

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Ex: ESOP with Many Over 70 ½

- However, both plans were operated as if “the later of” was adopted
- Both SPDs describe “later of” as the RMD date
- Plan had many participants over 70 ½

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## **Correcting Complex Failures**

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Ex: ESOP with Many Over 70 ½

What ER wants:

1. Full correction;
2. Allow those who want to keep their accounts in the Plan to do so

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## **Correcting Complex Failures**

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Ex: ESOP with Many Over 70 ½

Proposed Correction

- First, to avoid cutback, plan allows any participant over 70 ½ with an account to elect either: (i) RMDs that should have been made with continuing distribution, or (ii) delay until after retirement

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## **Correcting Complex Failures**

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Ex: ESOP with Many Over 70 ½

Proposed Correction

- Second, proposed that the Plan be retroactively amended to conform document to operation-i.e., to add the later of language.

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## **Correcting Complex Failures**

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Ex: ESOP with Many Over 70 ½

Proposed Correction

Evidence in support of ER intent & EE expectations:

1. language of SPD
2. operation of both plans

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## **Correcting Complex Failures**

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Ex: Unable to locate original Plan Adoption Agreement

- IRS will allow correction by submission of Schedule 2-Non-amender
- Generally, practitioners have been allowed to submit plans for which there are not documents without much trouble

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## **Correcting Complex Failures**

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Ex: Unable to locate original Plan Adoption Agreement

- 1 person PSP has missing original document and cannot locate subsequent amendments
- In addition, Plan Sponsor transferred on two occasions amounts from Plan to IRA on advice of now deceased investment advisor

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## **Correcting Complex Failures**

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Ex: Unable to locate original Plan Adoption Agreement

- Unlike all prior similar submissions, agent request:
  1. proof of when plan began, and
  2. evidence of Plan Sponsor's intent regarding in-service distribution option

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## **Correcting Complex Failures**

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Ex: Unable to locate original Plan Adoption Agreement

- Unlike all prior similar submissions, agent request:
  3. evidence that sole EE, who is also sponsor, was aware of original intent

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## **Correcting Complex Failures**

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Ex: Unable to locate original Plan Adoption Agreement

- Plan provides the following
  1. documentation of earliest contribution
  2. On issue of intent, Plan argues that the purpose of requiring intent is to protect EE's expectations from ER abuse-N/A

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## **Correcting Complex Failures**

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Ex: Mid-sized 401(k) with Leased EEs

- ER has always used Leased EEs from an agency
- Prototype previously excluded Leased Employees
- Restatement mistakenly drops exclusion

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## **Correcting Complex Failures**

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Ex: Mid-sized 401(k) with Leased EEs.

- Could be corrected under SCP but would require making contributions for all leased employees that satisfied requirements to enter the Plan

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## **Correcting Complex Failures**

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Ex: Mid-sized 401(k) with Leased EEs.

- What ER Wants:
  1. To correct
  2. But without the cost of contributions for leased employees

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## **Correcting Complex Failures**

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Ex: Mid-sized 401(k) with Leased EEs.

- Proposed Correction—Retroactively amend the Plan to put back exclusion for leased employees

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## **Correcting Complex Failures**

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Ex: Mid-sized 401(k) with Leased EEs

- Plan provides as evidence of ER

Intent:

1. Original Adoption Agreement
2. Employee Handbook stating no staffing employees eligible for benefits

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## **Correcting Complex Failures**

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Ex: Mid-sized 401(k) with Leased EEs

- Plan provides as evidence of EE

Expectations:

1. Staffing company handbook showing EEs receive benefits only from it and not from recipient companies
2. Plan sponsor handbook

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## **Correcting Complex Failures**

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Ex: Traditional 401(k) with Mandatory Match

- Plan amended from traditional 401(k) with a mandatory match to Safe Harbor
- Intent is that sole match will be Safe Harbor
- Unfortunately, plan discovers 3 years later that both traditional mandatory match and Safe Harbor match remain

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## **Correcting Complex Failures**

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Ex: Traditional 401(k) with Mandatory Match

- Plan could be corrected using SCP by providing both matches

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## **Correcting Complex Failures**

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Ex: Traditional 401(k) with Mandatory Match

- What ER wants:
  1. To correct
  2. But without contributing both matches

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## **Correcting Complex Failures**

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Ex: Traditional 401(k) with Mandatory Match

Proposed Correction--Retroactively remove traditional match

Plan must demonstrate both ER intent and EE expectations that only safe harbor match intended and expected

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## **Correcting Complex Failures**

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Ex: Traditional 401(k) with Mandatory Match

- Plan provides as evidence of ER intent and of EE Expectations:
  1. Safe Harbor Notices showing only the Safe Harbor match

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## **Correcting Complex Failures**

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Ex: Incorrect Titling of Account

- Small plan made up entirely of brokerage accounts—each incorrectly showing each EE as trustee
- When one EE attempts to move to another brokerage, account incorrectly established as IRA

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## **Correcting Complex Failures**

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Ex: Incorrect Titling of Account

- EE calls brokerage to arrange a loan from account and ends up receiving a distribution from the incorrectly established IRA

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## **Correcting Complex Failures**

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Ex: Incorrect Titling of Account

Proposed Correction:

1. having funds in IRA transferred back to Plan, and
2. distribution treated as loan and repaid to Plan

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## **Correcting Complex Failures**

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Ex: Incorrect Titling of Account

- Plan provides evidence that:
  1. intent was to remain part of 401(k) Plan
  2. intent was to take a loan and not a distribution
- Plan also added administrative safeguards

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## **Are these Trends?**

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I have noticed the following of late:

- IRS appears to be less flexible in dealing with failed contribution issues
- IRS appears to be less flexible in allowing correction by retroactive amendment

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## **Are these Trends?**

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I have noticed the following of late:

- More request for documentation on missing initial plan documents
- One Group Requesting ER Business Code ID for plan sponsor