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INSIGHT: IRS Expands Retirement Plan Self-Correction Options



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In 1990, the Internal Revenue Service first established the forerunner of the Employee Plans Compliance Resolution System (EPCRS). Since then the IRS has expanded and modified the correction principles and programs in an effort to address common issues and to encourage use of the programs.

As part of this ongoing evolution, the IRS recently published [Revenue Procedure 2019-19](#), modifying and replacing previous IRS guidance regarding the EPCRS. Under the EPCRS as it stands today, plan sponsors are encouraged and allowed to correct plan failures and thereby continue to provide employees with retirement benefits on a tax-favored basis through the Self-Correction Program (SCP), the Voluntary Correction Program (VCP), or the Audit Closing Agreement Program (Audit CAP).

Consistent with its policy to find, fix, and avoid plan errors, this latest iteration of the EPCRS most notably expands the SCP making it easier for plan sponsors to self-correct certain plan document and operational failures, including some plan loan failures. These changes to the EPCRS were immediately effective as of April 19, 2019.

Background on the SCP

The SCP permits a plan sponsor to correct certain insignificant or significant plan failures without contacting the IRS or paying a user fee. Under the SCP, insignificant failures can be self-corrected at any time, but significant failures must be substantially self-corrected before the end of the second plan year following the plan year in which the failure occurred (plan failures that are considered egregious are not eligible for self-correction). For this reason, the SCP requires an analysis of the facts and circumstances of the plan failure to

determine whether it is insignificant or significant, taking into consideration the following factors:

- Other failures occurring in the same period
- Percentage of plan assets and contributions involved in the failure
- Number of years the failure occurred
- Number of participants affected relative to the total number in the plan
- Number of participants affected relative to how many could have been affected
- Whether correction occurs within a reasonable time after discovery
- Reason for the failure

Even though no formal submission to the IRS is necessary when utilizing the SCP, it is important that any decision to self-correct be properly documented and all evidence of the correction, including a narrative describing the correction, be maintained by the plan sponsor because the plan sponsor will need to provide that information to the IRS upon audit or other potential inquiry.

Expanding Ability to Correct Certain Plan Document Failures Under the SCP

Effective April 19, 2019, if otherwise eligible to correct under the SCP, the plan sponsor of a qualified plan (including a tax code [Section 401\(k\)](#) plan) or a [Section 403\(b\)](#) plan may now correct certain plan document failures using the SCP. A plan document failure occurs when a plan provision (or the absence of a plan provision), on its face, violates the requirements of the federal tax code.

To correct plan document failures under the SCP, certain requirements must be met. First, because all plan document failures under the SCP are to be treated as significant failures, the correction must be substantially completed by the last day of the second plan year following the plan year in which the failure occurred (e.g., in a plan with a plan year ending December 31, a plan document failure occurring in 2019 must be substantially corrected by Dec. 31, 2021). Additionally, as of the date of correction, the plan must be the subject of a favorable letter (the definition of which depends on whether the plan is an individually-designed or pre-approved qualified plan or a 403(b) plan).

Nonetheless, the IRS has said that certain failures will not be considered plan document failures and therefore may not be self-corrected. Such excluded failures include the failure to timely adopt an initial 401(a) plan document, failure to timely adopt an initial written 403(b) plan, and failure to timely adopt corrective amendments resolving demographic failures. Correcting plan document failures under the SCP is also not available for SEPs or SIMPLE IRAs

New Rules for Correcting by Plan Amendment Under the SCP

Previously, under the VCP, a plan sponsor could correct certain operational plan failures with a retroactive plan amendment, conforming the terms of the plan to the plan's prior operations. Rev. Proc. 2019-19 adds new rules for self-correcting operational plan failures by retroactive plan amendment.

Under the new correction rules, to self-correct an operational plan failure by retroactive plan amendment, including a plan amendment to reflect corrective action, three conditions must be met. First, the plan amendment must result in an increase of benefits, rights, or features. Second, this increase in benefits, rights or features must also be provided to all employees eligible to participate in the plan. Finally, the increase in benefits, rights, or features must be permitted under the tax code and satisfy all other correction principles and applicable rules in the EPCRS. If the operational failure at issue did not provide for a uniform increase in benefits, rights or features to all employees eligible to participate in the plan, the SCP is not available to retroactively amend the written plan.

In addition, certain plan document failures may be corrected by plan amendment if the plan satisfies the conditions discussed above for self-correcting a plan document failure.

Modifying Plan Loan Failures Corrections Under the SCP

According to some studies, 90% of 401(k) plans offer loans, 40% of participants have opted to take loans, and participants default on 10% of loans each year. With this background, it is not difficult to see why plan loans can be the bane of a plan sponsor's existence because of the volume of failures that can occur and because of the employee relations toll and sensitive messaging involved when failures inevitably do occur. Plan loan failures can result from payroll glitches, integrating new acquisitions, or other administrative errors. The EPCRS and other programs have provided the framework for

correcting some plan loan failures and the latest enhancements to the SCP, described below, should be hailed as welcome news.

Reporting Deemed Distributions. If a plan loan does not meet the exceptions of [Section 72\(p\)\(2\)](#) or is in default and is not corrected, then a deemed distribution should be reported in the year of the correction instead of the year in which the failure occurred. Prior guidance permitted a plan sponsor, as part of the VCP or Audit CAP, to report the deemed distribution in the year of correction instead of the year of the failure only if the plan sponsor specifically requested that relief. A plan sponsor no longer needs to make such a request.

Defaulted Plan Loans. When a participant fails to repay a plan loan in accordance with plan terms, the loan should be defaulted for late, incorrect, or no payments. Under the expanded guidance, if a plan loan is in default, such failure can be corrected under the SCP by: (i) the participant making a single lump sum payment that includes all missed payments, including accrued interest; (ii) reamortizing the outstanding loan balance, including accrued interest, over the remaining payment schedule of the original loan or the period remaining had the loan been amortized over the maximum period that complies with Section 72(p)(2)(B), as measured from the original date of the loan; or (iii) any combination of (i) and (ii).

Failure to Obtain Spousal Consent for Plan Loan. Retirement plans offering a life annuity must obtain spousal consent as part of the loan procedures. If there was a failure to obtain spousal consent prior to the attainment of the plan loan, then the failure can be corrected under the SCP by notifying the affected participant and spouse (i.e., the spouse to whom the participant was married at the time of the plan loan) to obtain the spouse's consent. Note that if spousal consent is not obtained after reaching out to the spouse, the failure to obtain spousal consent must be corrected under the VCP or Audit CAP.

Number of Plan Loans Exceeds Number Permitted by Plan Document. Many retirement plans limit the number of loans a participant may have outstanding at any one time. If the plan allows a participant to obtain a number of loans in excess of what the plan document permits, the failure may now be corrected under the SCP through a retroactive plan amendment conforming the plan document to the plan's administration. In order to be a permissible retroactive amendment, the following conditions must be met: (i) the amendment must satisfy Section 401(a); (ii) the plan as amended would have satisfied Section 401(a) (and the requirements applicable to plan loans under Section 72(p)) had the amendment been adopted when the plan loans were first made available; and (iii) plan loans (including plan loans in excess of the number permitted under the terms of the plan) were available to either all participants, or solely to one or more participants who were nonhighly compensated employees.

Other EPCRS Modifications

Spousal Consent. In addition to allowing correction for failures to obtain spousal consent under the VCP, such failures may also now be corrected under the SCP and Audit CAP.

SCP Examples. A link to the IRS website has been added for plan sponsors to go to for additional ex-

amples illustrating whether an operational failure is significant or insignificant for purposes of the SCP.

VCP Submissions. The transitional rules added by [Rev. Proc. 2018-52](#) permitting paper VCP submissions to the IRS through March 31, 2019, have been removed with this new guidance. All VCP submissions must now be made electronically using pay.gov. This means plan sponsors should ensure that their VCP submissions are meeting all of the previously revised requirements for electronic submission.

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