A Timely Analysis of Legal Developments

ASAP®

February 14, 2013

The IRS's Retirement Plan Correction Program Has Been Updated and Expanded

by Steve Friedman and Stefanie Kastrinsky

On December 31, 2012, the IRS issued Revenue Procedure 2013-12, which updates and expands the IRS's Employee Plans Compliance Resolution System (EPCRS) – the IRS's "fix-it" program for retirement plan errors. Every few years, the IRS publishes an updated EPCRS guide, the last being Revenue Procedure 2008-50. Outlined below are some of the most significant changes that the IRS has made to EPCRS with Revenue Procedure 2013-12.

By way of background, EPCRS consists of three correction or "fix-it" programs: (1) self-correction (name speaks for itself)—the plan sponsors correct the error without seeking IRS approval; (2) the voluntary correction program (VCP), which requires a submission to the IRS for its approval of the manner of correction; and (3) Audit CAP, where the IRS discovers and allows for correction of failures on audit. Note that self-correction is only permitted under certain conditions. VCP and Audit CAP involve paying fees, with VCP fees being substantially less than Audit CAP fees.

EPCRS Expands Section 403(b) Plan Corrections

Revenue Procedure 2013-12 expands the type of corrections available to section 403(b) retirement plan sponsors. Previously, section 403(b) retirement plan sponsors could use EPCRS in very limited circumstances. Under Revenue Procedure 2013-12, a section 403(b) plan's error can generally be corrected using the same correction methodologies that are available to a qualified retirement plan (*e.g.*, a 401(k) plan or a pension plan). One particular measure of relief section 403(b) retirement plan sponsors had been waiting for—which is permitted under Revenue Procedure 2013-12—is the ability to submit a VCP application to obtain relief for the failure to timely adopt a written section 403(b) plan document (the adoption deadline had been December 31, 2009 for plans in existence prior to that date). For those non-timely adopters who submit their VCP applications on or before December 31, 2013, the IRS has agreed to reduce the VCP application fee by 50%, provided that this error is the only error included in the submission.

Revenue Procedure 2013-12 also added a "safe harbor" correction method for an employer's failure to heed section 403(b)'s "universal availability" requirement—the requirement that all eligible employees be permitted to make elective deferrals to the plan. The safe harbor requires that an employer provide a "missed deferral" contribution on an employee's behalf equal to the greater of: (a) 3% of the employee's compensation; or (b) the amount equal to the maximum elective deferral that would entitle the employee to the full plan match had the employee been able to make elective deferrals.

EPCRS Expanded to Take into Account IRC Section 436

Generally, Internal Revenue Code (IRC) section 436 imposes restrictions on certain defined benefit pension plans that do not meet funding requirements. These restrictions generally limit an employer's ability to amend the plan to increase benefits and limit the ability of the plan to make certain single sum distributions. For example, if the plan's adjusted funding target attainment percentage (the plan's assets/the plan's liabilities) is currently less than 80%, the plan cannot be amended to increase benefits unless the plan sponsor makes additional contributions to the plan to cover the cost of this amendment.

Revenue Procedure 2013-12 addresses errors involving IRC section 436 restrictions in two ways. First, it permits correction if the IRC section 436 restriction was ignored. For example, if a plan's adjusted funding target attainment percentage (the plan's assets/the plan's liabilities) is currently less than 80%, per IRC section 436 the plan cannot be amended to increase benefits unless the plan sponsor makes additional contributions to the plan to cover the cost of this amendment. Where a plan has been amended to increase benefits without meeting the above funding requirements or without having made the additional contributions, Revenue Procedure 2013-12 requires an employer to make the additional contributions described above, plus a payment of interest, calculated through the date the corrective payment is made.

Second, Revenue Procedure 2013-12 adjusted some correction methodologies to take into account the fact that some plans may be operating under IRC section 436 restrictions. For example, just like Revenue Procedure 2008-50, Revenue Procedure 2013-12 permits plan sponsors to correct a failure to obtain a spouse's consent to distribution, where such consent was required. Revenue Procedure 2013-12 continues to offer the same correction methodologies as Revenue Procedure 2008-50, which include: (a) obtaining the spouse's retroactive informed consent to the distribution; (b) providing a survivor annuity to the spouse equal to the portion of the qualified joint and survivor annuity that would have been payable to the spouse upon the death of the participant had a qualified joint and survivor annuity been provided to the participant under the plan at the participant's retirement date (which cannot be reduced to take into account the prior distribution made to the participant); or (c) distributing a single-sum payment to the spouse equal to the actuarial present value of the survivor annuity benefit (which cannot be actuarially reduced to take into account distributions already received by the participant). However, Revenue Procedure 2013-12 adds to the last correction, providing that where a plan is subject to a restriction on single-sum payments due to the operation of IRC section 436, the single-sum payment of the actuarial present value of the survivor benefit can be made only if the plan sponsor also makes a contribution to the plan (IRC section 436 limits a plan's ability to make lump sum payments if the plan's adjusted funding target attainment percentage is less than 80% and, with certain exceptions, completely prohibits lump sum payments if the plan's adjusted funding target attainment percentage is less than 60%). The amount of the required contribution to the plan depends upon the plan's adjusted funding target attainment percentage: (a) if the adjusted funding target attainment percentage is less than 60%, the plan sponsor must contribute an amount equal to 100% of the single-sum correction to the plan; and (b) if the adjusted funding target attainment percentage is 60% or greater, but less than 80%, then the plan sponsor must contribute an amount equal to 50% of the single-sum correction.

Self-Correction of Excess Annual Additions Under a Defined Contribution

Generally, in order to be eligible for self-correction, a plan sponsor or administrator must have established practices and procedures, either formal or informal, in place to promote compliance with the Internal Revenue Code and the plan's terms. In Revenue Procedure 2013-12, the IRS explained that, notwithstanding this general rule, a defined contribution plan will not be treated as failing to have established practices and procedures in place to prevent the occurrence of an IRC section 415(c) violation—*i.e.*, the plan has annual additions or contributions in excess of the IRC section 415(c) limitation—where the plan sponsor regularly self-corrects such violation by distributing the excess annual additions within 2½ months after the end of the plan's limitation year. In other words, the IRS has waived the "established practices and procedures" requirement where a plan sponsor self-corrects an IRC section 415(c) violation by distributing the excess annual additions within 2½ months after the end of the applicable limitation year. Note that this exception to the general requirement of established practices and procedures is only available where the plan provides for elective deferrals and non-elective contributions that are not matching contributions.

Change in the Treatment of Improperly Excluded Employees and Corrective Matching Contributions

Prior correction guidance provided that, under a non-safe harbor plan, if an employee should have been eligible for but did not receive an allocation of employer matching contributions, the employer would need to contribute a "qualified non-elective contribution" (or QNEC). A QNEC is a fully vested employer contribution. Revenue Procedure 2013-12 provides that a corrective contribution for missed matching contributions is not required to be treated as a QNEC, but rather as a regular matching contribution. The fact that these corrective contributions are treated as matching contributions and not QNECs is significant. First, it means that the corrective matching contributions are subject to the plan's matching contribution vesting schedule; QNECs are required to be 100% vested. Second, it means that these corrective matching contributions are not subject to certain distribution limitations imposed on QNECs—for example, QNECs are not available for hardship withdrawal.

Additional Steps Required to Locate Lost Participants and Beneficiaries who Are Owed Additional Benefits

Revenue Procedure 2013-12 expands the steps that employers must take to locate former participants. Plan sponsors have long been required to take "reasonable actions" to locate former participants and beneficiaries who are owed additional retirement benefits as a result of correction. Revenue Procedure 2013-12 has expanded upon what constitutes reasonable action. Previously, the retirement plan sponsor could attempt to locate the individual through mailing to his or her last known address, and, if that was unsuccessful, attempt to locate the individual through the use of the IRS letter forwarding program (which is no longer available for this purpose) or the Social Security letter forwarding program.

Now, if the individual is not located after regular mail has been sent to his or her last known address, the plan sponsor is required to send a certified mailing to the last known address, and, if this proves unsuccessful, the retirement plan sponsor must employ an additional search method, such as the Social Security letter forwarding program, a commercial locator service, a credit reporting agency, or internet search tool. The IRS has also indicated that, depending upon the facts and circumstances, the use of more than one of these additional search methods may be appropriate.

Changes to the VCP Application Format and Mailing Address

Revenue Procedure 2013-12 made substantial changes to the format of the VCP application, with the intent, it seems, of simplifying the VCP application and making it more user-friendly. Beginning April 1, 2013 (or sooner, if the retirement plan sponsor opts to apply the provisions of Revenue Procedure 2013-12 before that date), retirement plan sponsors no longer have to decide whether they should file an "Appendix D" or "Appendix F" application, as was required under Revenue Procedure 2008-50. Instead, they can use the two-part model VCP submission document found in Appendix C of Revenue Procedure 2013-12. The first part of the application is nearly identical to Appendix D in Revenue Procedure 2008-50—it requires plan identifying information, a description of the failures, a description of the proposed method of correction, and identification of any excise tax or other tax relief being sought, to name a few aspects.

The second part of the new application consists of schedules that cover certain failures—nearly the same schedules that were part of Appendix F of Revenue Procedure 2008-50. In some instances, Revenue Procedure 2013-12's schedules helpfully guide the user through the completion of the application, telling the reader which section or schedule to complete next if the answer to a particular question is "yes" or "no."

The applicant will also have to include two new forms with any VCP submission. First, Form 8950, "Application for Voluntary Correction Program," which requires the applicant to attest, under penalty of perjury, that he or she has reviewed the submission and documents and that the documents and facts presented are true, correct, and complete, to the best of his or her knowledge and belief. Second, Form 8951, "Compliance Fee for Application for Voluntary Correction Program Submission under the Employee Plans Compliance Resolution System," which helps the applicant determine the appropriate fee to be submitted.

With respect to the mailing address change, beginning April 1, 2013 (or sooner, if the retirement plan sponsors opts to apply the provisions of Revenue Procedure 2013-12 before that date), the sponsor must send any VCP submissions to: IRS, P.O. Box 12192, Covington, KY 41012-0192, instead of to the IRS's facility in Washington, D.C. Apparently, the IRS will be processing VCP submissions out of its Covington, Kentucky office, which is also where it does the bulk of its determination letter application reviews.

Effective Date of the New Revenue Procedure

Although Revenue Procedure 2013-12's effective date is April 1, 2013, retirement plan sponsors are permitted to apply its provisions to corrections made on or after December 31, 2012, provided that they include Forms 8950 and 8951 with any VCP submissions and send the submission to the IRS's Covington, Kentucky mailing address.

Steven Friedman, Co-Chair of Littler Mendelson's Employee Benefits Practice Group, is a Shareholder in the New York City office, where Stefanie Kastrinsky is an Associate. If you would like further information, please contact your Littler attorney at 1.888.Littler or, info@littler.com, Mr. Friedman at sfriedman@littler.com, or Ms. Kastrinsky at skastrinsky@littler.com.