

**MEMO# 14844**

July 1, 2002

# **IRS ISSUES UPDATED EPCRS REVENUE PROCEDURE AND REVENUE RULING ON EFFECT OF "RESTORATIVE" PLAN PAYMENTS**

[14844] July 1, 2002 TO: PENSION MEMBERS No. 30-02 PENSION OPERATIONS ADVISORY COMMITTEE No. 43-02 IRS CORRECTION PROGRAMS AD HOC COMMITTEE RE: IRS ISSUES UPDATED EPCRS REVENUE PROCEDURE AND REVENUE RULING ON EFFECT OF "RESTORATIVE" PLAN PAYMENTS The Internal Revenue Service has issued Revenue Procedure 2002-47, which updates the Employee Plans Compliance Resolution System (EPCRS), the comprehensive system of correction programs for retirement plans under Code sections 401(a), 403(a), 403(b) and 408(k). Revenue Procedure 2002-47 modifies and supercedes Revenue Procedure 2001-17,<sup>1</sup> the prior consolidated guidance on EPCRS. The IRS also recently issued Revenue Ruling 2002-45, which provides that "restorative" payments to qualified defined contribution plans are not treated as contributions for purposes of Code sections 401(a)(4), 401(k)(3), 401(m), 404, 415(c) or 4972. REVENUE PROCEDURE 2002-47 — EPCRS Program Modifications. Although EPCRS generally retains the same program structure as previously set forth in Revenue Procedure 2001-17,<sup>2</sup> Revenue Procedure 2002-47 modifies EPCRS in a number of respects. Notably, several changes to EPCRS address recommendations previously made by the Institute.<sup>3</sup> Specifically, the new revenue procedure: 1 See Institute Memorandum to Pension Members No. 5-01, Pension Operations Advisory Committee No. 9-01, Ad Hoc Committee on IRS Group Correction Program, dated January 26, 2001. 2 The three primary components of EPCRS remain the Self-Correction Program (SCP), the Voluntary Correction with Service Approval program (VCP), and the Correction on Audit program (Audit CAP). VCP includes the following programs: VCO — Voluntary Correction of Operational Failures; VCS — Voluntary Correction of Operational Failures Standardized; VCT — Voluntary Correction of Tax-sheltered Annuity Failures; VCGroup — Voluntary Correction of Group Failures; VCSEP — Voluntary Correction of SEP Failures; and the Anonymous Submission Procedure. 3 See, e.g., adoption of an anonymous submission program for the group correction program, expansion of de minimis exceptions for certain failures. See Institute Memorandum to Pension Committee No. 86-00, Pension Operations Advisory Committee 83-00, Ad Hoc Committee on IRS Group Correction Program, dated November 14, 2000; Institute Memorandum to Pension Committee No. 66-99, November 22, 1999. 2 • extends the Anonymous Submission Procedure indefinitely and expands the program to cover failures listed in Appendix A (operational failures under VCS) and Appendix B (examples of failures/correction methods for qualified plans); • expands the Anonymous Submission Procedure to VCGroup and VCSEP submissions; • expands the VCGroup procedures to

permit eligible organizations to submit operational and plan document failures in a single submission; • clarifies that information identifying the applicable plan(s), plan sponsor(s) or the eligible organization may be excluded from the initial submission under the Anonymous Submission Procedure (however, the State of the plan sponsor must be identified in the initial submission); • increases the de minimis amount relating to corrective distributions to \$50 or less (rather than \$20 or less); • provides a de minimis rule for correcting overpayments under which plan sponsors are not required to seek the return of an overpayment to a participant or beneficiary where the overpayment is \$100 or less; • clarifies the date by which correction of a failure related to transferred assets must be completed; • extends the duration of the SCP self-correction period for significant operational compliance failures where the plan sponsor assumes a plan in connection with a corporate merger, acquisition or other similar transaction; • expands the definition of “Employer Eligibility Failure” to include the adoption of a 401(k) plan by an ineligible employer; • clarifies that VCP covers the correction of failures in a terminated plan; • updates the definition of “favorable letter” for various types of plans; • modifies the correction procedure relating to excess amounts under the VCT program and overcontributions under VCSEP; • clarifies the factors considered under Audit CAP for determining sanction amounts; and • revises the Appendix C checklist to include questions on transferred assets and the waiver of the excise tax under Code section 4974. Comments Requested. The revenue procedure provides that EPCRS will continue to be updated on a periodic basis, and that the IRS and the Treasury Department continue to invite comments on how to improve EPCRS. The IRS and Treasury are particularly interested in receiving comments on appropriate correction procedures for failures arising under SIMPLE IRAs and 457(b) plans.<sup>4</sup> To the extent that you have comments on these matters or the guidance set forth in Revenue Procedure 2002-47, please contact the undersigned at (202) 326-5837 or tkim@ici.org. Effective Date. Revenue Procedure 2002-47 is effective July 22, 2002. 4 The revenue procedure notes that submissions relating to SIMPLE IRAs are currently being accepted by the IRS on a provisional basis outside of EPCRS, and that submissions relating to 457(b) eligible plans may be accepted outside of EPCRS as the Employee Plans Division of the IRS gains more experience with regard to such plans. 3 REVENUE RULING 2002-45 — EFFECT OF “RESTORATIVE” PLAN PAYMENTS Revenue Ruling 2002-45 holds that “restorative payments” made to a qualified defined contribution plan under Code section 401(a) are not treated as contributions for purposes of Code sections 401(a)(4) (containing general nondiscrimination standards); 401(k)(3) (containing participation and nondiscrimination standards for elective deferrals); 401(m) (containing rules for employer matching and nonelective contributions); 404 (providing deductibility limits applicable to employer contributions); 415(c) (providing the “annual additions” limit for defined contribution plans); or 4972 (imposing an excise tax on nondeductible contributions made to certain plans). The revenue ruling provides that whether a payment to a qualified defined contribution plan is treated as a restorative payment — rather than a contribution — is based on all of the relevant facts and circumstances. Generally, however, restorative payments are those made in order to restore some or all of a plan’s losses due to an action or failure to act that creates a “reasonable risk of liability for breach of fiduciary duty.” For instance, payments made to a plan pursuant to a court-approved settlement or a Department of Labor order to restore plan losses due to a possible fiduciary breach would generally meet this standard. Under the facts presented, the IRS ruled that plan payments made by an employer (1) pursuant to a court-approved settlement agreement or (2) based on the employer’s assessment that it has a reasonable risk of liability for fiduciary breach (even in the absence of a lawsuit) would constitute restorative payments. Accordingly, such payments would not be treated as a contribution to a plan, and thus, would not be taken into account under Code sections 401(a)(4), 401(k)(3), 401(m), 404, 415(c) or 4972. By

contrast, payments made to a plan to make up for losses due to market fluctuations not attributable to a fiduciary breach are contributions, not restorative payments. Additionally, neither amounts paid in excess of the amount lost (including appropriate adjustments to reflect lost earnings) nor payments resulting in different treatment of similarly-situated participants are restorative payments. The revenue ruling also provides that in no event are payments required under a plan or payments necessary to comply with Code requirements considered restorative payments, even if the payments were otherwise delayed or made in circumstances relating to a fiduciary breach. For example, payments made under EPCRS or the Department of Labor's Voluntary Fiduciary Correction (VFC) program<sup>5</sup> are not considered restorative payments. However, the payment of appropriate adjustments to reflect lost earnings required under EPCRS is generally treated in the same manner as a restorative payment. Thomas T. Kim Associate Counsel Attachments 5 See Institute Memorandum to Pension Members No. 13-02, Pension Operations Advisory Committee No. 21-02, dated April 5, 2002. 4 Note: Not all recipients receive the attachments. To obtain copies of the attachments, please visit our members website (<http://members.ici.org>) and search for memo 14844, or call the ICI Library at (202) 326-8304 and request the attachments for memo 14844. Attachment no. 1 (in .pdf format)

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