

**MEMO# 20043**

May 12, 2006

## **IRS Releases Revised Employee Plans Compliance Resolution System**

©2006 Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice. [20043] May 12, 2006 TO: PENSION COMMITTEE No. 16-06 PENSION OPERATIONS ADVISORY COMMITTEE No. 16-06 RE: IRS RELEASES REVISED EMPLOYEE PLANS COMPLIANCE RESOLUTION SYSTEM The IRS has released Revenue Procedure 2006-27,<sup>1</sup> an update and revision of its Employee Plans Compliance Resolution System (EPCRS), the first since 2003. EPCRS provides sponsors of qualified plans, 403(b) plans, SEPs and SIMPLE IRAs a method to correct failures to satisfy applicable Internal Revenue Code requirements. The latest revision generally retains the basic structure of Revenue Procedure 2003-44.<sup>2</sup> It expands the correction methods and scope of relief, streamlines submission procedures, clarifies definitions, and alters certain fees. This memo describes some of the major substantive changes.<sup>3</sup>

**Exclusion of Employees from Making Elective Contributions** A common complaint about EPCRS related to the approved method for correcting a failure to allow eligible employees to contribute to the plan. Previously, the approved method required a contribution to an affected employee's account equal the actual deferral percentage (ADP) for the employee's group (highly or non-highly compensated) for the year of the failure times the employee's eligible compensation, or in the case of after-tax contribution, using the actual contribution percentage (ACP) instead of ADP.<sup>4</sup>

<sup>1</sup> A copy of Rev. Proc. 2006-27 is available at <http://www.irs.gov/pub/irs-drop/rp-06-27.pdf>. <sup>2</sup> See Memorandum to Pension Members No. 27-03, Pension Operations Advisory Committee No. 32-03; IRS Correction Programs Ad Hoc Committee [16180], dated June 9, 2003. <sup>3</sup> For a more comprehensive list of the changes made to EPCRS, see Section 2.01 of Rev. Proc. 2006-27. In addition, the IRS has prepared a chart comparing Rev. Proc. 2006-27 to its predecessor Rev. Proc. 2003-44, available here: [http://www.irs.gov/pub/irs-tege/rp0627\\_summary.pdf](http://www.irs.gov/pub/irs-tege/rp0627_summary.pdf). <sup>4</sup> Some felt that this method provided too large of a benefit to affected employees who, after all, received cash in lieu of a contribution to the plan. Perhaps acknowledging this complaint, the revision to EPCRS suggests that the new approved method, the contribution is 50% of this amount for missed pre-tax contributions, or 40% of this amount for after-tax contributions.<sup>5</sup> If the plan allowed matching contributions, the matching contribution that must be made up is determined without regard to the 50% or 40% reduction, as applicable. As under the prior EPCRS, the corrective contribution is generally treated like a qualified non-elective contribution (QNC). These new corrections are not available for the failure to allow eligible employees to make designated Roth contributions. **Correction of Loan Failures** Previously, EPCRS provided very limited relief for participants when there was an error relating to a plan loan. The revision adds approved corrections for situations where a participant loan exceeded the maximum amount allowed by Code 72(p)(2)(A), exceeded

the maximum duration allowed by Code 72(p)(2)(B), did not satisfy the level amortization requirement in Code 72(p)(2)(C), or was defaulted because of a repayment failure. These corrections are available only if corrected through Voluntary Correction Procedures (VCP) but if used the deemed distribution is not required to be reported on Form 1099-R and does not cause the participant to have additional basis in the participant's account. In addition, EPCRS now allows a plan to correct, through retroactive amendment, the making of plan loans before the plan is amended to allow loans.

**Failure to Obtain Spousal Consent**  
Previously, EPCRS provided that, where a plan failed to obtain spousal consent for a distribution subject to Code 401(a)(11) and 417, the pre-approved correction was to obtain the consent, and if consent is not obtained, to provide the spouse with a benefit under the plan equal to the portion of a qualified joint and survivor annuity that would have been payable upon the death of the participant. EPCRS has been revised to allow the plan to offer the spouse a choice between this benefit or a lump sum payment equal to the actuarial present value of the benefit (calculated under Code 417(e)).

**Submission of Determination Letter Request**  
The rules regarding a parallel submission of a determination letter under VCP have been modified to take into account the IRS' new remedial amendment cycles. For plan amendments made under the Self Correction Procedures (SCP), EPCRS now simply requires that the amendment be submitted for a determination letter before the end of the plan's applicable remedial amendment period.

**method is intended to "make[] up for the value of the lost opportunity to the employee to have a portion of his or her compensation contributed to the plan accumulated with earnings tax free in the future."** 5 The approved correction for safe harbor 401(k) plans uses a different formula for determining the assumed missed deferral.

**3 Orphan Plans**  
EPCRS was amended to include special procedures for corrections relating to terminating "Orphan Plans," which include plans abandoned pursuant to the Department of Labor's new regulations.<sup>6</sup>

**An "Eligible Party,"** which is generally a court-appointed representative or the person or entity with responsibility under DOL's regulations, must act on behalf of plan. The IRS states that, for a terminating Orphan Plan, it reserves the discretion to waive the VCP fee and determine whether full correction will be required.

**Correction of Excess Contributions**  
Generally, correction under EPCRS does not excuse excise taxes with limited exceptions. The revision allows waiver of the excise tax under Code 4979 in "appropriate cases, e.g., where correction is made for any case in which the ADP test was timely performed but, due to the reliance on inaccurate data, resulted in an insufficient amount of excess elective contributions having been distributed to HCEs."

**Fee Changes**  
IRS has reduced the EPCRS application fees:

- where the sole failure is the failure to satisfy the minimum distribution requirements of Code 401(a)(9) for 50 or fewer participants,
- where the sole failure is the failure to amend the plan timely with respect to certain required amendments,<sup>7</sup> and
- for applications from SEPs and SIMPLE IRAs.

The IRS added a schedule of penalties that will be imposed if a plan's failure to be amended in accordance with changes in the law is not voluntarily identified by the plan sponsor but instead is discovered by the IRS as part of a determination letter application. The IRS states that if the failure to amend is discovered during an examination, the fee is expected to be even higher.

**Effective Date**  
The changes made to EPCRS by Revenue Procedure 2006-27 are generally effective on September 1, 2006, although a plan can apply the changes on or after May 30, 2006.<sup>8</sup>

**6 See Memorandum to Pension Members No. 30-06 [20005], dated May 4, 2006.**

**7 A new Appendix F, with streamlined procedures for nonamender failures, was added.**

**8 Specifically, the changes are effective (a) for SCP, for failures for which correction is not complete by September 1, 2006; (b) for VCP, for applications submitted on or after September 1, 2006; and (c) for Audit CAP, for examinations begun on or after September 1, 2006.**

**4 Comments Requested**  
The IRS has requested comments on future enhancements to the program, including:

- methods that could be pre-approved to correct the failure to

provide eligible employees the opportunity to make catch-up contributions; • methods that could be pre-approved to correct the failure to provide eligible employees the opportunity to make designated Roth contributions; • corrections for excess annual additions, which were removed in the proposed regulations under Code 415; and • whether additional correction methods are needed to take advantage of DOL's fiduciary safe harbor for abandoned plans, where the plan is subject to the requirements of Code 401(a)(11) and 417 in light of the ability to satisfy those requirements by purchase of a commercial annuity contract. Because EPCRS is an ongoing program that is updated from time to time, the IRS does not provide a deadline for comments on these issues or other comments on how to improve the program. The Institute will prepare a comment letter if there is sufficient member interest. Please provide any comments or suggestions to the undersigned. Michael L. Hadley Assistant Counsel

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