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401(k) Plan Corrections – Can Your Company Benefit From the New IRS Guidance?

On December 31, 2012, the Internal Revenue Service ("IRS") issued Revenue Procedure 2013-12. This new Revenue Procedure modifies and supersedes Revenue Procedure 2008-50 and provides significant changes to the Employee Plans Compliance Resolution Systems ("EPCRS"). Although the Revenue Procedure is generally effective April 1, 2013, plan sponsors may elect to apply its provisions earlier using the recently released application forms. Among other changes, the Revenue Procedure permits 403(b) plan sponsors to correct plan failures in the same manner as qualified plans, provides new submission procedures and forms, revises the actions that plan sponsors must take to locate missing participants, and updates some of the compliance fees.

The EPCRS program enables companies that sponsor qualified retirement plans (i.e.: 401(k)) to correct plan errors that could adversely affect the qualification of the plan resulting in adverse tax consequences for both the company and each individual employee. The four major types of failures that are correctable under EPCRS include plan document failures, operational failures, demographic failures and employer eligibility failures. In our experience, most client plan failures are classified as "operational failures" which arise when the company has simply failed to follow the terms of the plan. The most common operational failures involve (1) failure to use the correct definition of compensation for contribution purposes, (2) failure to include all eligible employees (part-time employees), (3) loan duration or repayments, (4) failure to implement an employee election and (5) exclusion of eligible employees from catch-up contributions. The EPCRS program provides three correction programs:

- **Self-correction (SCP):** If the company has established compliance practices and procedures, the company is permitted to self-correct insignificant operational failures at any time. If the failure is considered significant, the company may still be able to self-correct the failures if completed by no later than the last day of the second plan year following the plan year in which the failure(s) occurred. Self-correction does not require the company to report the failure to the IRS, nor does it require the payments of any compliance fees to the IRS.

- **Voluntary Correction with Service Approval (VCP):** A company is permitted to submit an application to the IRS and pay a limited compliance fee. By voluntarily filing under VCP, the company receives IRS approval of the correction method(s) taken, thereby reducing the company's concern regarding any

potential tax liability for itself and its employees under self-correction. When the IRS issues a compliance statement to a company, it signifies that the IRS will not treat the plan as having failed to satisfy the tax qualified requirements of the Code due to the failures described in the submission. Unless already subject to an IRS plan audit, a company can file a VCP at any time. That said, the longer a company delays in correcting an operational error, the more money it will cost the company to correct the errors.

- **Correction on Audit (Audit CAP):** If the IRS identifies a failure first, based on an audit of the plan, the company is required to correct the error and pay a sanction. The amount of the sanction depends on the nature, extent and severity of the failure(s), taking into account any corrections which may have occurred prior to the audit.

Having assisted several clients with identifying and correcting plan failures under SCP or VCP, we encourage companies to periodically review their 401(k) plan documents, processes and procedures in order to maintain the tax favored treatment for both the employee and the company. Should you have any questions on the operation of your 401(k) plan, please call your MFEM relationship attorney for assistance.