Voluntary Fiduciary Correction Program + Self-Correction Program

When VCP is required?

Presenter Information

Stephen W. Forbes J.D., LL.M.

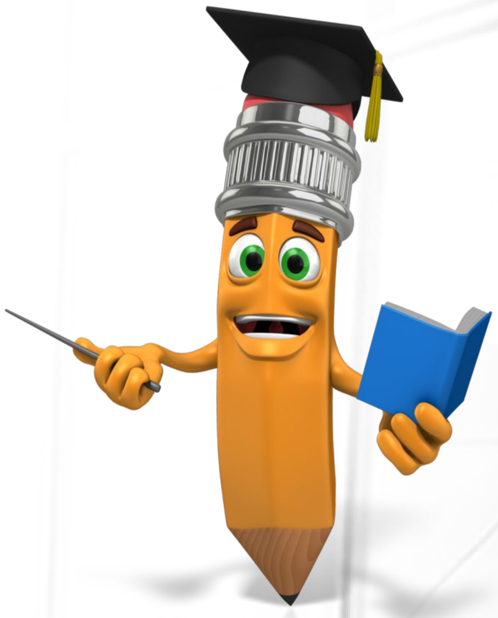
Forbes Retirement Plan Consulting

(720) 799-7039

stephen.forbes32@gmail.com

What we'll cover

- Revised VFCP
- Self-Correction Component
- Participant loans
- Delinquent deposit of deferrals and participant loan repayments
- Form 5500
- Self-correction under SECURE 2.0
- Notice 2023-43
- Timing of correction
- When should a plan use VCP?
- Scrivener's error



Revised VFCP

Updated VFCP

- In January 2025, the DOL issued an updated version of the Voluntary Fiduciary Correction Program ("VFCP")
  - The updated VFCP includes a new **self-correction component** ("SCC")
  - This new update became effective March 17, 2025

VFCP

- The DOL initially created VFCP in 2002
  - The objective was to create a program that would allow a plan sponsor or other party to correct a prohibited transaction ("PT")
    - ERISA §406(a) and Code §4975(c)
    - The Code also covers prohibited transactions that occur in IRAs

Prohibited Transaction

- A PT occurs when a Party-in-Interest (ERISA) or Disqualified Person (Code) enters into a direct or indirect transaction involving the plan or IRA
  - The presumption is that such a transaction is either a conflict of interest or an act of self-dealing
  - These rules are designed to create a bright line for plan sponsors to follow
  - The rules are meant to avoid even an appearance of impropriety on the part of people who have access to plan assets

19 Prohibited Transactions

- VFCP has limitations as to the type of transactions that can be corrected under the program
  - There are 19 identified correctable transactions
  - Failure to deposit deferrals and loan repayments timely is the top reason why fiduciaries use VFCP

19 Correctable Transactions

1. Delinquent Participant Contributions and Participant Loan Repayments to Pension Plans;
2. Delinquent Participant Contributions to Insured Welfare Plans;
3. Delinquent Participant Contributions to Welfare Plan Trusts;
4. Fair Market Interest Rate Loans to Parties in Interest;
5. Below Market Interest Rate Loans to Parties in Interest;
6. Below Market Interest Rate Loans to Non-Parties in Interest;
7. Below Market Interest Rate Loans Due to Delay in Perfecting Security Interest;
8. Participant Loans Failing to Comply with Plan Provisions for Amount, Duration, or Level Amortization;
9. Defaulted Participant Loans;

19 Correctable Transactions

10. Purchase of Assets by Plans from Parties in Interest;
11. Sale of Assets by Plans to Parties in Interest;
12. Sale and Leaseback of Property to Sponsoring Employers;
13. Purchase of Assets from Non-Parties in Interest at More Than Fair Market Value;
14. Sale of Assets to Non-Parties in Interest at Less Than Fair Market Value;
15. Holding of an Illiquid Asset Previously Purchased by Plan;
16. Benefit Payments Based on Improper Valuation of Plan Assets;
17. Payment of Duplicate, Excessive, or Unnecessary Compensation;
18. Improper Payment of Expenses by Plan; and
19. Payment of Dual Compensation to Plan Fiduciaries.

VFCP Application

- VFCP provides very specific methods on how to correct each of the transactions available under the program
- If the VFCP application is flawed, the DOL can return the application without further contact (which starts the process all over again), or request additional information
- If the application remains flawed and/or the request is not answered, the DOL can decide to negotiate for a different correction and impose the ERISA §502(l) 20% penalty
  - Alternatively, the DOL can choose to take any other “appropriate” action, including an investigation

VFCP Eligibility

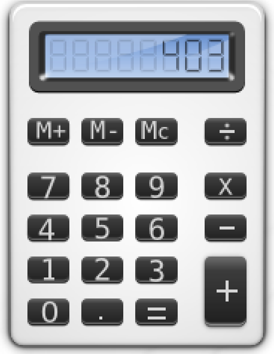
- Similar to EPCRS, there are eligibility restrictions for an applicant to use VFCP
  - An Applicant cannot be **under investigation by the DOL** while filing under VFCP or have been informed in writing that the transaction in question has been **referred to the IRS**
  - The program may not be used to absolve any **criminal activity**
    - However, a PT involving criminal activity can be filed for VFCP by an innocent fiduciary if certain other requirements (including reporting the crime to law enforcement) are met

Plan Assets

- The costs related to the VFCP process cannot be paid for by plan assets (including forfeitures)
- Restriction includes any earnings owed to the plan, legal fees, administrative fees for the work done on the calculations, all penalties and sanctions, and any filing fees or closing costs

DOL online calculator

- The methods for calculating both fair market value and earnings on late deposits are outlined in VFCP
  - If the PT involved the inappropriate purchase or sale of property using plan assets, the fiduciary cannot just go online and check on Zillow to determine the value
    - An independent appraisal that meets industry standards is required
  - DOL online calculator
    - It is one of the benefits of using VFCP or SCC
    - The online calculator is available to calculate the interest due on late deposits



Self-Correction Component (SCC)

- One of the key features of the updated version of VFCP is the addition of the SCC
  - This program is very limited.
  - There are only two types of PTs that may be self-corrected:

1. delinquent participant contributions and loan repayments; and
2. eligible inadvertent participant loan failures

Late Deposits

- What makes a deposit late?
  - A deposit is late if it is not made within the timing set forth under DOL Reg. §2510.3-102
    - The earliest day on which such contributions or repayments can reasonably be segregated from the employer's general assets
  - For large (i.e., 100 or more participants) plans, this is as soon as administratively feasible, which generally has been referred to mean the date required under the employer's deposit schedule for federal and state withholding in relation to a given payroll
  - For small plans, the safe harbor is for deferrals and loan payments to be deposited to the plan within 7 business days

SCC Restrictions

- Restrictions
  - Earnings on the late deposits can’t be more than $1,000
  - Late payments under VFCP must be deposited to the plan within 180 days of when they were received by the employer or the date on which the amounts would otherwise have been paid to the participants (i.e., the payroll date)
- Example
  - If a plan has one late deposit in March 2025 and it gets caught by the large plan auditor in October 2026, it will already be too late to use SCC
  - If these limitations are not met, then a full VFCP filing is needed (if the plan official chooses to correct using VFCP), even for late deposits

Participant Loans

- SCC also permits self-correction of eligible inadvertent participant loan failures
  - Any loan failure that can be self-corrected under the IRS's EPCRS program
  - These covered failures include:
    - Noncompliance with plan terms, including the amount, duration, or level amortization of the loan
    - Loans that defaulted due to failure to withhold from the participant's wages
    - Failure to obtain mandatory spousal consent
    - Allowing a loan that exceeds the number of loans permitted under the plan

Participant loan failures

- Section 305(b)(2) of the SECURE 2.0 Act requires the DOL to treat eligible inadvertent failures related to participant loans that are self-corrected under EPCRS as meeting the requirements of VFCP "if, with respect to the violation of the fiduciary standards of ERISA, there is a similar loan error eligible for correction under the IRS's EPCRS and the loan error is corrected in such manner."
- Section 305(b)(3) of the SECURE 2.0 Act permits the DOL to impose reporting or other procedural requirements with respect to parties that intend to rely on VFCP for correction of these eligible inadvertent failures

Participant loan failures (cont.)

- The DOL modified VFCP section 7.3 to accept EPCRS self-corrections of eligible inadvertent failures of participant loan transactions.
  - Specifically, VFCP adds a new self-correction component in section 7.3(c) entitled "Eligible Inadvertent Participant Loan Failures Corrected under the Self-Correction Component."
- In addition, a new exception is added to section 4 titled "Exception for Eligible Inadvertent Participant Loan Failures" to clarify that a self-corrector is eligible to correct an Eligible Inadvertent Participant Loan Failure under section 7.3(c) even if the plan or the self-corrector is "Under Investigation," within the meaning of VFCP so long as the self-corrector is eligible to correct the participant loan failure under EPCRS

Participant loan failures - SCC

- SCC will initially accept only a correction that involves obtaining spousal consent, unless and until additional correction methods are identified in an updated EPCRS
- The DOL intends to monitor use of the SCC as well as any additional changes to EPCRS to determine whether additional guidance appears necessary on the scope of the SCC in section 7.3(c) or on any correction methods

Participant loan failures - SCC

- Under section 7.3(c), self-correctors are required to complete a SCC notice and submit the notice electronically to EBSA using the online VFCP web tool located on EBSA's website
- Self-correctors are also required to complete and retain the documents required under section 6.2 (including the Penalty of Perjury Statement)

Loan issue

- How should a plan classify the following failure:
  - Loan payment withheld from employee's paycheck
  - The employer fails to deposit the loan repayments timely
- As a result of the failure to deposit the loan repayments, the loan may be defaulted, so does this qualify for this SCC option?
- Or, is it a late deposit failure?
- The answer is that it's a late deposit failure by the employer, which can be corrected under EPCRS self-correction (thereby avoiding taxation of the loan to the participant) and also under SCC for a late deposit; it is not an inadvertent participant loan failure

PTE 2002-51

- PTE 2002-51 provides the VFCP Applicant with relief from certain excise taxes if all the requirements of VFCP are met
  - This exemption only applies to 6 of the 19 PTs that can be corrected under VFCP:

1. Failure to timely remit participant contributions and/or loan repayments
2. Loans made at a fair market interest rate by the plan to a PII
3. Purchase or sale of assets at fair market value between a plan and a PII
4. Sale of real property to a plan by an employer at fair market value and leaseback of the property at fair market rental value
5. Purchase or sale of illiquid assets by plans
6. Use of plan assets to pay fees that are “settlor” expenses to service providers, if such payments are not expressly prohibited in the plan document

SCC Process

- Unlike the self-correction program under EPCRS, the SCC Applicant must make a submission to the DOL
  - The Applicant must still prepare and retain everything as if they were filing a regular VFCP application, but the submission to the DOL only includes:
    - an SCC notice,
    - model authorization, and
    - SCC Record Retention Checklist (Appendix F of the new VFCP)
  - All of this is uploaded through a new online VFCP website.

Penalty of Perjury Statement

- One key piece that must be retained is a penalty of perjury statement signed and dated by each plan official who is seeking relief under the SCC
- When you have a multiple or multiemployer plan, only the participating employer impacted by the PT will need to sign the penalty of perjury statement

Acknowledgement email

- In exchange for filing under SCC, all the employer gets back is an acknowledgement email (not a “no action letter”)
- There is no assurance that the DOL won’t pick the case up for investigation
- This is precisely the reason why many practitioners don’t advise using VFCP for late deposits or loan issues except in very unusual circumstances
- Unlike filing the VCP through the IRS, which protects the transaction from any possible examination review, there is nothing in the VFCP affording a plan sponsor any such protection

Voluntary

- There is no requirement to file through VFCP
  - Plan sponsors still need to correct the late deposits with earnings and file the Form 5330 to pay applicable excise taxes, but they don't need to file under VFCP
  - Without a VFCP filing, however, the DOL's position is that the DOL Online Calculator to determine the lost earnings is not available
  - Instead, the IRS earnings method from EPCRS should be used

Three options for correcting late deposit of deferrals and loan repayments

- According to EBSA, failure to deposit participant contributions to the plan "*as soon as they reasonably can be segregated from the company's general assets*" is among the most frequent errors made by employer sponsored retirement plans
- With the release of the revised VFCP, what are the correction options for delinquent participant contributions and loan repayments?

1. File under VFCP and receive a no action letter
2. Correct under the new SCC and receive a DOL acknowledgement
3. Self-correct outside of VFCP and SCC

Option #1

- To file under VFCP, the plan simply need to follow the procedure outlined in the 2025 procedure
- Violations can be corrected in following steps:

1. If the employer has not deposited the deferrals with the plan, the employer should immediately deposit the deferrals
2. Identify the date on which the employer should have deposited the deferrals;
3. Calculate the earnings (may use the DOL calculator) from on the earliest date on which the participant contributions or loan repayments could reasonably have been segregated from the employer's general assets (i.e., the date on which the contributions become plan assets under DOL Reg. 2510.3-102).
4. Report the late deposit on the Form 5500. Make certain the plan reports that the failure is being corrected under VFCP
5. File an application with the appropriate EBSA regional office and include documentation showing evidence of corrective action taken

Option #2 - SCC

- Employers can use the SCC to voluntarily self-correct delinquent participant contributions and loan repayments if lost earnings total $1,000 or less. To correct under SCC, the plan must:

1. If the employer has not deposited the deferrals with the plan, the employer should immediately deposit the deferrals
   a) To qualify for SCC, the employer must remit delinquent payments to the plan within 180 calendar days from the date of withholding from participants' paychecks;
2. Compute lost earnings on the delinquent payments <u>from the date of withholding from participants' paychecks</u> (*i.e., not the date the contributions should have been deposited with the plan*) or receipt by the employer, using the online calculator;
3. Pay any penalties (PT excise tax);
4. Report the delinquent contributions on Form 5500; and
5. Ensure neither the party-in-interest nor the plan is "under investigation"
6. File SCC notice with the DOL

Option #3 – Self Correction

- To self-correct (i.e., not utilize VFCP or SCC), the plan should follow the following steps:

1. If the employer has not deposited the deferrals with the plan, the employer should immediately deposit the deferrals (or loan payments) into the plan trust

2. Calculate and remit the earnings;

   a) The plan should use the SCC method for calculating earnings (i.e., payroll date)

3. Report the late deposit on the Form 5500. Make certain the plan also reports that the failure is being corrected outside of VFCP

4. Pay prohibited transaction excise tax (Form 5330)

The DOL's position is that the DOL calculator is reserved from corrections under VFCP and SCC. The DOL recommends using one of the methods from EPCRS (other than the DOL calculator). However, it is important to note that most practitioners who self-correct continue to use the DOL calculator with no repercussion from the DOL.

Form 5500 reporting

- VFCP does not relieve plans from reporting delinquent participant contributions on the plan's Form 5500 or Form 5500-SF, as applicable.
  - That remains the case regardless of whether corrected under the SCC or VFCP
- Form 5500 (Line 4a of the Schedule H or Schedule I for small plans; line 9(a) of the Schedule DCG) or Form 5500-SF (Line 10a)
- The Form 5500 instructions also permit a preparer to include an attachment specifying the status of the correction

Form 5500 attachment

Schedule I Line 4a – Schedule of Delinquent Participant Contributions

Participant Contributions Transferred Late to Plan	Total that Constitutes Nonexempt Prohibited Transactions			Total Fully Corrected Under VFCP and PTE 2002-51
Check here if Late Participant Loan Repayments are included:	Contributions Not Corrected	Contributions Corrected Outside VFCP	Contributions Pending Correction in VFCP	

Multiple Prohibited Transactions?

- **If an employer is delinquent in depositing deferrals or loan repayments for more than one pay period, does the employer have multiple prohibited transactions, or, a single prohibited transaction?**
- *The DOL has permitted delinquent contributions for more than one pay period to be treated as one transaction under the VFCP if the pay periods are close together in time and the delinquencies are related to the same cause*

EPCRS - Earnings Rate

- **Multiple investment funds**:
  - The rate is based on the **participant's investment choices**
  - If most of the employees are NHCEs, the rate can be the fund with the **highest rate of return** for the period failure
  - If the employee has not made an investment choice, the rate can be the **average of the rates** earned by all of the funds weighted by the portion of the plan assets invested in the various funds

EPCRS - Earnings Calculations for Safe Harbor Correction Methods for Elective Deferral Failures

- Alternative method for calculating earnings for elective deferral failures, including for corrective contributions for the matching contributions
  - If an affected employee has not affirmatively made investment choices under the plan, the employer may calculate the missed earnings on the basis of the plan's **default investment alternative**
  - Any accumulated **losses** will not result in a reduction in the required corrective contributions

EPCRS - Reasonable Estimates

- In making an earnings adjustment to a corrective contribution, allocation or distribution, if either:
  - It is possible to make a precise calculation but the probable difference between the approximate and the precise calculation of earnings is insignificant and the administrative cost of determining precise earnings would significantly exceed the probable difference, or
  - It is not possible to make a precise calculation (for example, where it is impossible to obtain all of the plan data)
- The employer may use reasonable estimates in calculating the earnings adjustment

DOL Invitation to file under VFCP

- Many plan sponsors that reported late deposits on Form 5500 receive a letter from the DOL inviting telling them to file under VFCP
- The plan sponsor should reply to the letter that they have corrected the failure in accordance with the VFCP requirements
  - Contribute late deposits plus earnings, and
  - File Form 5330 with PT excise tax
- My experience is that the DOL is satisfied with the response and there is no follow-up investigation
- There is no negative impact for skipping the VFCP filing should the client later be investigated

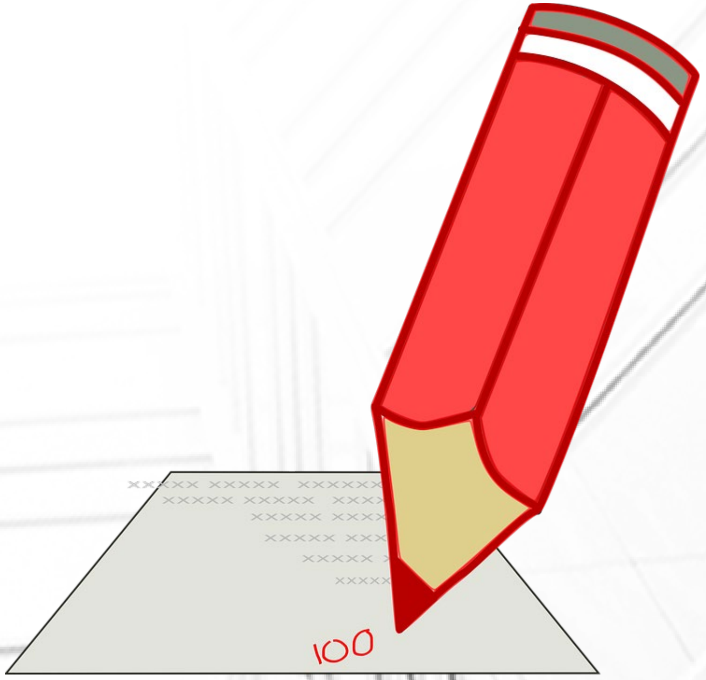
Use Fees

- VFCP has no user fee
- The cost for preparing a proper filing, plus the risk that the DOL will reject the proposed filing for technical reasons and initiate an investigation, may make the entire thing not worthwhile for just a few late deposits
- Another reason VFCP is less attractive
  - A plan sponsor may only get one bite at this apple
- If a plan sponsor is a repeat offender with late deposits and they try to use the SCC multiple times, they will likely find themselves in an investigation, as noted by the DOL in the Preamble
  - The plan sponsor would do better to improve the timeliness of deposits instead

De minimis exception

- VFCP provides a de minimis exception that applies to corrective distributions of less than $35 each to former employees, their beneficiaries, and alternate payees who neither have account balances with nor have a right to future benefits from the plan if the applicant demonstrates that the cost of making a distribution to the individual exceeds the amount of the corrective payment
- In that case, the distribution does not have to be paid to the individuals but rather the total amount can be paid to the plan

Self-Correction Under SECURE 2.0



Unlimited Self-Correction

- Any **eligible inadvertent failure** to comply with the rules may be self-corrected
- No time limit! Unless:
  - IRS catches failure prior to "any actions which demonstrate a specific commitment to implement a self-correction with respect to such failure," or
  - Self-correction is not completed within a reasonable period after failure is identified
- Directs the IRS to issue new EPCRS procedure within 2 years
  - Didn't happen

Act Section
305
Code Section
EPCRS
Qualified
Yes
403(b)
Yes
457(b)
No
Eff. Date

Eligible Inadvertent Failures

- Eligible inadvertent failures includes:
  - Plan document failures
    - Restatement
    - Interim and discretionary amendments
  - Demographic failures (coverage, nondiscrimination, minimum participation)

Unlimited Self-Correction - Loans

- Also includes participant loan failures
  - Self-correction satisfies DOL VFCP
  - DOL can impose reporting or procedural requirements
    - Perhaps like the proposed regulations for self-correction of late deferrals
- Self-correction of inadvertent IRA failures
  - Including waiver of RMD penalty tax
  - Including errors in rolling over inherited IRAs
  - Not effective until IRS issues new Revenue Procedure

Unlimited Self-Correction – Methods, Failures

- IRS can require specific correction methods
  - And provide general principals for other situations
  - Eligible inadvertent failure is a failure that occurs despite <u>**practices and procedures**</u>
    - Doesn’t include:
      - Egregious failures
      - Diversion or misuse of assets
      - Abusive tax avoidance transaction

Correction of Inadvertent Benefit Overpayments

- Gives plan fiduciary the option of not trying to recoup prior overpayments
  - Not ERISA fiduciary breach
- Plan sponsor can amend plan to increase past or decrease future payments to adjust for prior overpayments
- Doesn’t relieve employer of funding obligations
- Plan must comply with §415 and compensation limits

Act Section
301
Code Section
414(a)(aa)
Qualified
Yes
403(b)
Yes
457(b)
No
Eff. Date
Enactment

Inadvertent Overpayments

- If overpayment has been rolled over:
  - The rollover is ok if plan does not seek to recoup
  - If plan does seek to recoup, can roll the money back without tax
- Can continue prior installment payments or benefit reduction
- Many details in new ERISA §206(h) to protect innocent recipient
  - If fiduciary decides to recoup, no interest or collection fees
  - Can’t recoup overpayments to participant from spouse or beneficiaries
  - 3-year statute of limitations on recoupment

Safe Harbor Correction – auto enrollment

- EPCRS has 0% QNEC “safe harbor” correction of deferral in auto enrollment/auto escalation plan if corrected 9½ months after end of plan year
- Sunsets 12/31/2023
- Congress made it permanent; no sunset!
- Other rules to qualify for the safe harbor still apply

Act Section
350
Code Section
414(cc)
Qualified
Yes
403(b)
Yes
457(b)
Yes
Eff. Date
Failures after 2023

Safe Harbor Correction for a 401(k) plan with an Automatic Contribution Feature

- EPCRS provides a safe harbor correction method for a 401(k) plan that includes an automatic contribution arrangement
- Under the safe harbor, the employer does **not** have to make a corrective contribution for an elective deferral failure (failure to implement and improper exclusion) in a 401(k) plan with an automatic contribution arrangement provided the following conditions are satisfied:

1. Correct elective deferrals begin by the first payroll date on or after the earlier of:
   a) **9½ months** after the end of the plan year in which the failure first occurred; or
   b) The last day of the month after the month the affected employee first **notified** the employer of the failure.

Safe Harbor Correction for a 401(k) plan with an Automatic Contribution Feature

2. The employer provides a **notice** of the failure to the affected participants not later than 45 days after the date on which the correct deferrals begin. and

3. If the eligible employee would have been entitled to additional **matching contributions** on the missed deferrals, the employer makes a corrective allocation equal to the matching contributions that would have been allocated on the missed deferrals. These contributions must be made within the two year timeframe for correcting significant operational failures.

Example

- Company X maintains a QACA with the matching contribution formula (100% on the 1% of deferrals and 50% match on deferrals between 1% and 6%)
  - Ann becomes eligible for the plan on January 1, 2024
  - Ann makes neither an affirmative election nor a contrary election
  - Ann's compensation is $5,000/month
  - X fails to implement the 3% automatic elective deferral for Ann until January 1, 2025
  - X will not need to make a corrective contribution for the 2022 missed deferrals
  - However, X will need to make a corrective allocation of $1,200 for the matching contributions on the missed deferrals (2% [100% x 1% + 50% on the next 2% of deferrals] x $60,000)
  - X also will need to provide Ann with a notice

Self-Correction Program Retroactive Corrective Amendments

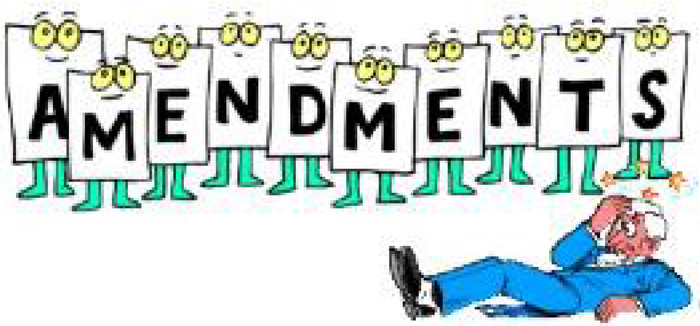
- The most frequent qualification error: failure to comply with the terms of the plan
- Fortunately, practitioners can self-correct most operational errors without the need to involve the IRS or pay a sanction to the IRS
- Correction of an operational error: ER puts the plan and the participants in the position they would have been if the error had not occurred
- What if the correction requires the ER to amend the plan (e.g., coverage or demographic failure):
  - Previously, EPCRS generally required the plan to file under VCP
  - Under Section 305, we can now self-correct

11(g) Amendment to Correct Demographic Failures

- An employer may now self-correct
  - Coverage failures
  - Nondiscrimination failures
  - Plan document failures
- What if the coverage or nondiscrimination failure (demographic failure) requires a plan amendment to correct the failure
  - The plan amendment must use a method set forth in Treas. Reg. §1.401(a)(4)-11(g) (11(g) amendment)

11(g) Amendment

- Through the 11(g) amendment, the ER
  - may add participants, or
  - increase allocations sufficient to pass the failed test
- In addition, a plan sponsor may use the 11(g) amendment to correct a failure regarding the current availability of a benefit, right or feature



11(g) Amendment Conditions

- In order for regulations to recognize an 11(g) amendment, the amendment must satisfy the following conditions:

1. The amendment cannot reduce a participant's benefit
2. The amendment must be generally effective as if the amendment were in effect on the first day of the plan year being corrected
3. The ER must adopt the amendment within 9½ months after the close of the plan year
4. The additional allocations must satisfy the coverage and nondiscrimination requirements on their own
5. If the amendment corrects the current availability of a benefit, right or feature, the amendment cannot be part of a pattern of amendments to correct repeated failures and the amendment must remain in effect through the end of the first plan year beginning after the date of the amendment
6. 401(k) plan: amendment may be considered for coverage purposes only if it provides a QNEC to NHCEs who were not eligible to defer. The QNEC must equal the average ADP of the group of NHCEs who were eligible to defer. 401(m) plan: amendment may be considered only if it provides a QNEC to NHCEs who were not eligible for the match. The QNEC must equal the average ACP of the group of NHCEs who were eligible for the match.

Document Failures

- As noted earlier, cannot self-correct failure to initially adopt plan
  - Ongoing question: what about related employer’s failure to adopt controlled/affiliated service group plan?
- Is this a failure to initially adopt or an operational failure of covering people not eligible to participate?
- Because plan has been adopted by “employer” (under CG/ASG rules), I feel it is an operational failure that can be self-corrected

Correcting Operational Failure by Plan Amendment

- Plan does not operate according to its terms and client wants to amend the plan to match operations
  - Not a document failure, but the correction of an operational failure by amendment
  - Historically, such self-corrections were limited by EPCRS
  - Notice permits self-correction of operational failure by amendment to align plan with actual operations
  - No benefit may be less favorable to participant than under original provisions
- No limitation to BRF issues

Notice 2023-43

Good News from the IRS!

What plan failures may be self-corrected?

- **Eligible Inadvertent Failure (EIF)**
  - Section 305 provides that any EIF that fails to comply with the qualified plan, 403(b), SEP or SIMPLE IRA rules may be self-corrected, except to the extent the failure was identified by the IRS prior to any actions that demonstrate a specific commitment to implement a self-correction with respect to such failure, or the self-correction is not completed within a reasonable period after identification of the failure
- **Indefinite.** Section 305 also provides that, for purposes of self-correction of an EIF, the <u>correction period is indefinite</u>, other than with respect to <u>failures identified by the IRS prior to any actions that demonstrate a specific commitment to implement a self-correction</u>
- **All plan failures.** In other words, effectively all plan failures may now be self-corrected unless the IRS identifies the failure before you have started the correction, or, the IRS has identified the failure as not eligible for self-correction

What self-correction rules are no longer applicable?

The Notice provides a list of provisions in the current version of EPCRS relating to self-correction that no longer apply:

1. the requirement that a qualified plan or 403(b) plan have a favorable determination letter;
2. the prohibition of self-correction of demographic failures and employer eligibility failures;
3. the prohibition of self-correction for significant failures of SEPs or SIMPLE IRAs;
4. the prohibition of self-correction of certain loan failures; and
5. the requirement that a significant failure must be completed or substantially completed by the end of the third plan year following the year in which it occurred.

Insignificant Failures

- If the IRS identifies a plan failure in IRS examination and the failure is "insignificant," may the plan still self-correct the failure?
  - **Yes**. Under EPCRS, if a failure is insignificant, there is no time limit on correcting the failure and the employer may correct the failure even if it is identified in an IRS examination
  - The Notice makes it clear that this position continues under the expanded self-correction

What plan failures may <u>not</u> be self-corrected?

- The list of failures that, until EPCRS is updated, may not be self-corrected:

1. the failure to <u>initially</u> adopt a written plan document;
2. failures in orphan plans;
3. a significant failure in a terminated plan;
4. a demographic failure that is corrected not using a method set forth in Treas. Reg. §1.401(a)(4)-11(g);
5. an operational failure that is corrected by a plan amendment that conforms the terms of the plan to the plan's prior operations in a manner that is less favorable for a participant than the original terms of the plan (scrivener's error);
6. excess contributions to a SEP or SIMPLE IRA that remain in the participant's IRA;
7. failures in SEPs or SIMPLE IRAs that do not use model or prototype forms; and
8. a failure in an ESOP involving Code §409.

Effective Date

- The Notice confirms that a practitioner may use Section 305 immediately and provides interim guidance, which is in effect until EPCRS is updated
- Section 305 applies to failures that occurred prior to its enactment

Timing of Correction

Insignificant Failure

- An insignificant failure is effectively a subcategory under EIF
  - If a failure is insignificant, there is **no** deadline for correcting the failure
  - However, by delaying the correction of the failure, the plan is:
    - increasing the contribution for the earnings
    - Increasing the risk the IRS “picks up” the plan and challenges the determination of the failure as insignificant

EIF Timeline

- An EIF may be self-corrected, except to the extent the failure was identified by the IRS:
  - prior to any actions that demonstrate a specific commitment to implement a self-correction with respect to such failure, or
  - the self-correction is not completed within a reasonable period after identification of the failure
- **Indefinite.** The correction period for an EIF is indefinite except
  - For failures identified by the IRS prior to any actions that demonstrate a specific commitment to implement a self-correction

Identified?

- If the IRS has identified the failure, it is too late to self-correct a significant failure absent a “specific commitment to correct”
- Notice 2023-43 uses the EPCRS definition of “Under Examination”

Under Examination

- Plan is under an Employee Plans examination; or
- Plan sponsor is under an Exempt Organization examination; or
- Plan is under investigation by the Criminal Investigation Division of the IRS; or
- Plan or Plan Sponsor (or authorized representative) has received verbal or written communication of impending examination or referral for examination; or
- Plan/Plan Sponsor in appeals or litigation from something that arose under Employee Plans or Exempt Organization examinations

Demonstration of a specific commitment to implement a self-correction

- What demonstrates a specific commitment to implement a self-correction?
  - Would simply identifying the failure be sufficient? **Probably not**
  - How about hiring someone to correct the failure? **Close call, but it's probably sufficient**
  - How about if the plan correction has commenced? **This should be sufficient**

- ***Note:*** *An important part of demonstrating a specific commitment to implement self-correction is documentation. The plan should maintain documentation indicating when the failure was identified and what steps have been taken.*

Example

- Employer identifies failure on Monday
- On Tuesday, employer retains lawyer to help it correct the failure and begins collecting information to send to lawyer
- On Wednesday, before any additional corrective activity has begun, the IRS issues an examination notice
- The IRS should consider the employer to have made a specific commitment to correct; self-correction is still permitted

Example

- Employer identifies failure on Monday
  - On Tuesday, employer retains lawyer to help it correct the failure and begins collecting data to send to lawyer
  - 12 months later, no correction activity has occurred
  - IRS issues exam notice on 12 months and one day
  - Did the failure to act for 12 months negate the specific commitment to correct?

- 26

Completion within a reasonable period after identification of the failure

- Generally, the IRS requires that a plan correction be completed within 18 months following identification
- If the failure is not corrected within the **18 month** period, the IRS may place the correction under Audit CAP and impose a sanction

Correction Documentation

- If requested upon an IRS examination, an employer must be able to provide documentation substantiating the self-correction, such as:

1. **identifies the failure**, including the years of occurrence, the number of employees affected, and the date the failure was identified;
2. explains **how the failure occurred** and demonstrates there were established practices and procedures (formal or informal) reasonably designed to promote and facilitate overall compliance that were in effect when the failure occurred;
3. identifies and substantiates the **correction method** and the date of the completion of the correction; and
4. **identifies any changes** made to those established practices and procedures to ensure that the same failure would not recur.

Practices and Procedures

- The IRS requires that the plan have practices and procedures in place when the failure occurred
  - EPCRS provides that:
    - The procedures may be formal or informal (but how do you prove the existence of informal procedures?)
    - Must be "reasonably designed to promote and facilitate overall compliance in form and operation" with the Code

- 30

When should a plan use VCP?

Department of the Treasury
Internal Revenue Service

VCP Requirements

- An ER, at any time before the plan is under IRS examination, may pay an user fee (from $1,500 to $3,500, depending on the amount of plan assets) and receive IRS approval for a particular correction of a qualification failure or 403(b) failure
  - Qualified Plans, 403(b) Plans, SEPs, and SIMPLE IRA Plans are eligible for VCP
- VCP provides procedures for correction of all Qualification Failures:
  - Operational,
  - Plan Document (i.e., the plan document fails to include required language),
  - Demographic (i.e., a coverage, nondiscrimination or minimum participation failure that is not an operational failure), and
  - Employer Eligibility (e.g.., an adoption of a 401(k) plan by an employer that is not eligible to establish a 401(k) plan).

Why would a plan file under VCP?

- Failure is not eligible for self-correction (not many)
- Employer wants a compliance statement from the IRS
- Employer is attempting an aggressive correction method for which EPCRS does not provide
  - The IRS has approved methods I normally think they wouldn't approve
- Scrivener's errors

Recommended Correction Methods

- A practitioner should never leave it to the IRS to identify the correction method
  - If you don't like their proposed correction method, they are unlikely to accept an alternative correction method
- Practitioner should propose correction method
  - Have a rationale for your proposed correction methods
  - Little risk in being aggressive in your recommended correction method
  - Practitioners are often surprised at what the IRS will approve – one of the advantages of VCP

No Concurrent IRS Examination

- Except in unusual circumstances, if an employer properly files a VCP submission, the IRS will **not examine** the plan while the submission is pending
- If the IRS contacts the employer regarding an examination, the **employer should inform** the IRS that it has a VCP submission pending
- Once informed, the IRS will **delay or cancel** the examination.
- However, if the plan is involved in a **group VCP submission**, the IRS is not precluded from initiating an examination on any plan which is part of the group submission, even while the submission is pending

VCP User Fees

Plans with asset of:	
$500,000 or less	$1,500
Over $500,000 to $10,000,000	$3,000
Over $10,000,000	$3,500

- The employer determines the user fee for a VCP submission based on end of year net assets of a plan as reported on the most recently filed Form 5500
- For plans not required to file a Form 5500, the amount of net assets for purposes of the user fee will be the amount of net assets as of the last day of the most recently completed plan year preceding the date of the VCP submission

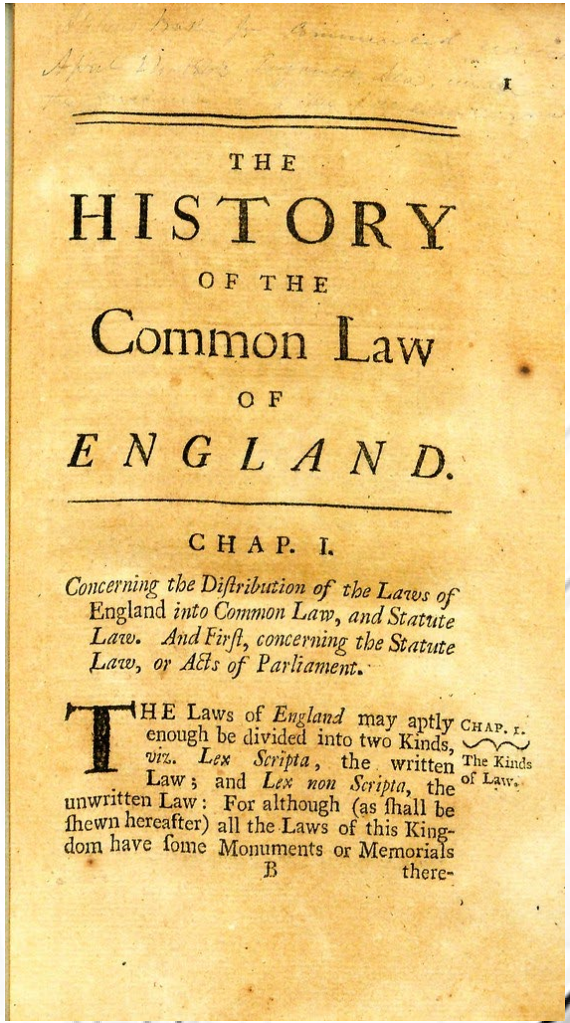
Pre-submission Conference

- In place of the Anonymous Submission process, the IRS has provided a Pres-submission Conference
- Under this procedure, beginning in 2022, the practitioner will submit a filing using a revised Form 8950, outlining substantially all of the information about the situation that would be required in a VCP filing:
  - a description of the failures and how they occurred,
  - the proposed method of correction,
  - the facts (including the type of participants affected);
  - relevant plan provisions and amendments; and
  - any other relevant information.

Pre-submission Conference

- How likely is it that the IRS will ultimately rule differently in the VCP filing than indicated by its representative in a conference?
  - Any agreement or understanding is not binding upon the IRS
  - IRS will provide a written acknowledgement of the conference
- The effectiveness of the conference will depend on:
  - the conference is with someone knowledgeable;
  - the IRS representative will provide insight that is not normally available to someone outside the Service that will give the pre-submission conference procedure real value;
  - that the IRS representative will be clear as to what is likely to be permissible and what has more risk of being rejected; and
  - the IRS representative will offer viable alternatives if the proposed correction is unacceptable.

Scrivener's Error


THE

HISTORY

OF THE

Common Law

OF

ENGLAND.

CHAP. I.

Concerning the Diſtribution of the Laws of England *into Common Law, and Statute Law. And Firſt, concerning the Statute Law, or Acts of Parliament.*

THE Laws of *England* may aptly enough be divided into two Kinds, *viz. Lex Scripta*, the written Law; and *Lex non Scripta*, the unwritten Law: For although (as ſhall be ſhewn hereafter) all the Laws of this Kingdom have ſome Monuments or Memorials there-

CHAP. I. The Kinds of Law.

Examples of Scriveners' errors

- Contrary to the ER's intention, plan document:
  - Included bonuses for allocation purposes
  - Used full year's compensation rather than compensation while a participant
  - Reflected a higher matching contribution %
  - Made increased contribution % retroactively effective
  - Failed to exclude certain categories of EEs
  - Provided a nonintegrated rather than an integrated formula
  - Provided immediate eligibility rather than one year/age 21
  - Misidentified classifications in a cross-tested plan
  - Reflected the wrong vesting schedule
  - Included a related ER

Correction options

- **VCP.** File under VCP and ask the IRS to approve reformation of the plan document
  - To have a chance of success, will need extrinsic evidence of intention
    - SPD, correspondence, participant communications, etc.
- **Live with it.** Recognize that plan is effectively a contract and mistakes are generally construed against the drafter
  - Amend prospectively
  - To make the ER "whole," the ER can reduce future contributions until ER has recovered "overcontribution"

    Ex: Company X intended to exclude bonuses in making fixed matching contributions

    - Plan document provided for W-2 compensation
    - Discovered error after three years
    - X corrects by making corrective contribution
    - X corrects plan document and lowers future match % until it "recovers" unintended contribution

Scrivener's Error Doctrine

- The plan may disregard benefit provisions of a plan document if:
  1. Other governing document (e.g., SPD, collective bargaining agreements) or objective evidence (e.g., participant communications) shows the provisions are ambiguous
  2. Mutual mistake
- Although in a few instances the IRS has permitted a plan sponsor to reform a document as part of a VCP correction, the IRS generally feels that they do **not** have the authority to equitably reform plan documents
  - Participants should be able to rely on the written plan document
  - Anticutback rule
- In a number of cases, the courts have recognized that application of the doctrine to an ERISA plan

Scrivener’s Error

- Establishing a scrivener’s error is more difficult because many practitioners use systems that create SPD from elections in the plan document
  - In other words, an error in the plan document likely will also show up in the SPD

Example

- Company X maintains a 401(k) plan
  - The plan traditionally imposed eligibility conditions of 1 YOS/age 21/ semi-annual entry dates
  - When the plan was restated, the practitioner checked the box that provided immediate eligibility
    - SPD reflected the document elections
  - What possible evidence could establish that the election was a scrivener's error?
    - ER's or practitioner's verbal statements – No
    - Correspondence that ER wants the same document provisions as in previous document – Yes
    - Email that ER wants no changes in eligibility provisions – Yes
    - Prior documents - Yes

Example

- LTD, Inc. maintains a 401(k) plan
  - The plan's compensation definition excluded bonuses
  - When the plan was restated, the practitioner checked the box for W-2 (no exclusion of bonuses)
    - SPD reflected the document elections
    - Elective deferrals and employer contributions were determined as if bonuses were excluded
  - What possible evidence could establish that the election was a scrivener's error?
    - ER's or practitioner's verbal statements – No
    - Correspondence that ER wants the same document provisions as in previous document – Yes
    - Email that ER wants no changes in eligibility provisions – Yes
    - Prior documents - Yes

Failure to make an RMD

- Making RMDs is a qualification requirement
  - Failure to make an RMD is a disqualifying defect
- Participant (or beneficiary) also is subject to a 25% (reduced from 50%) excise tax on the shortfall
  - Code 4974
  - Form 5329
- If the RMD is corrected (make-up missed RMD) by the end of the second year after the year it was due, the penalty is further reduced to 10%
- Not so good news: Previously, the penalty was so draconian that IRS frequently waived it. Under the new reduced penalty provision, the IRS may be less likely to waive.
- 4 Correction Options

Correction option #1: Correct by second tax year

- Make-up missed RMDs (plus earnings) by the end of the second tax year after the year it was due
- Pay the 10% excise tax

Correction Option #2: Form 5329 Waiver

- Self-correct the qualification failure by making-up missed RMDs
- Request waiver of excise tax on Form 5329
- The instructions to the form permit the participant to calculate the penalty and enter “RC” and the amount you want waived in parentheses on the dotted line of line 54
- The participant also would attach a statement to the form requesting the waiver and explaining the reasonable error
- *Note: Although the Form 5329 provides a reasonable method for requesting a waiver of the excise tax, many participants are reticent to report their error to the Revenue Service.*

Correction Option #3: VCP

- Make-up the missed RMDs
- File under VCP
- If the plan sponsor files under VCP, the plan sponsor may request a waiver of the excise taxes for all of the affected participants
  - Previously, the IRS has been generous in granting waivers

Correction option #4: Self-Correction

- Make-up missed RMDs (plus earnings)
  - The failure is operational so SCP should be available
- Rely on regulatory waiver of excise tax for “reasonable cause”
  - Recommendation: write-up reasonable cause statement and place in the file
- If the IRS doesn’t audit the plan, then no disqualification or excise tax issues
- If the IRS audits the plan, inform them that failure was self-corrected and that excise tax should be waived because of reasonable cause (document it)

THANK YOU