Phone Forum transcript for the Current Developments and Issues from the Office of Employee Plans, Rulings and Agreements

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Moderator: Ladies and gentlemen, thank you for standing by and welcome to this Current Developments and Issues from the Office of Employee Plans, Rulings, and Agreements Phone Forum. All participants are in a listen-only mode. As a reminder, today's program is being recorded. I would now like to hand the forum over to your host, Mr. John Schmidt. Please go ahead, sir.

J. Schmidt: Great. Thank you very much, Lisa. Hello everybody. I'm John Schmidt the Staff Assistant within Customer Education and Outreach for the IRS's Office of Employee Plans. I'd like to welcome you today to our phone forum entitled *Current Developments and Issues from the Office of Employee Plans, Rulings, and Agreements*.

Today we're fortunate enough to have, and are going to be hearing from, Andrew Zuckerman, the Director of Employee Plans, Rulings, and Agreements; Vicky Surguy, the Manager of EP Determinations; and Keith Ruprecht, a Group Manager within Voluntary Compliance.

Before we start, I'd like to point out a couple of administrative type items. Everyone registered for this forum today will receive a certificate of completion by e-mail approximately one week after the forum. You must attend the entire live forum to receive a certificate. Enrolled Agents, Enrolled Retirement Plan Agents, and Enrolled Actuaries are entitled to continuing professional education credit for this session. Other types of tax professionals should consult their licensing organization to see if this session qualifies for continuing professional or educational credit.

For more information regarding Employee Plans, Rulings, and Agreements, please visit the Retirement Plans web site at www.irs.gov/ep. You can also get there by going to the main IRS web page and clicking on the Retirement Plans Community tab across the top of the screen. Look to the left hand navigation bar and click on More Topics to find the web link for Public Guidance, Correcting Plan Errors and Determinations, Opinion and Advisory Letters for Retirement Plans.

Once visiting our web site you might also want to subscribe to one or both of our free electronic newsletters. The link for newsletters is also in the left hand navigation bar. As I mentioned, we have two newsletters, *The Retirement News for Employers* for small employers sponsoring a retirement plan, and *The Retirement Plan News* for retirement plan professionals.

So having run through those few administrative things, it's my pleasure to turn the microphone over to Andy Zuckerman.

A. Zuckerman: Good afternoon or good morning everyone depending where you're calling from. Thank you, John. As John said, I'm the Director of Employee Plans, Rulings, and Agreements. There is an awful lot of material, awful lot of things going on, hot topics, whatever you want to call it, current developments. We sent out, I believe, a PowerPoint that I'm going to generally follow, but I'm not going to stick to it explicitly because we just won't get through the presentation if I do. Let me just start out with this first slide and then we'll almost immediately start to vary from it.

EP Rulings and Agreements consists of five functions and they all, while dealing with the pension area, with the retirement plan area, they're job functions are very different. I'm going to be talking about what's hot in some of these various functions, not all of them, but I think they're all – what I will be talking to you hopefully will be of interest.

The five distinct functions are: Employee Plans – Technical, that function is the one that answers questions from our determination technical questions from our determination function from taxpayers. They work on private letter rulings and other various areas pitching in special projects.

The second is EP Technical Guidance and Quality Assurance – what we refer to as Guidance. We work with Counsel and Treasury to help draft regulations, publish revenue rulings, announcements, notices, and anything else that we put out to the public, up to and including, articles and materials for the web site, the EP web site that our Customer Education and Outreach function operates.

The third is EP Determinations – that's headed up by Vickie Surguy. That's the function that issues all the determination letters and the opinion letters and advisory letters on the volume submitters and master and prototype plans. Our Quality Assurance function is to review function for Determinations making sure the work is correct, and our Voluntary Compliance function, EPCRS, which is 80% to 85% under the control of Rulings and Agreements. The other 15% or so deals with audit caps and is under the Exam Division in Employee Plans which is headed up by Monika Templeman.

I'm just going to be touching on a few points, hot topics in each of these areas. I'm going to start first with what's happening in the determination letter area – that's always something that people are very interested in. We are currently working on making changes to the Determination Letter Program, or are at least looking into it. We have been through our first set of five six-year cycles under the staggered determination letter approach. We have taken a look back to see what did we do well; what didn't we do well; what could we change to make things easier on the taxpayer; to make things easier on the practitioners, and to make things easier on ourselves in the coming years.

We noticed that we could see that because of the economy and what's going on in Congress that we're not going to have much opportunity in all likelihood to be doing much attrition hiring so we're going to have to be more efficient with how we're getting work done because otherwise we will not be able to turn over our inventory as quickly as you would like us to.

Two years ago – we have an advisory committee, a formal advisory committee that did a report that focused on improvements in the determination letter area. Out of that report and out of some internal reviews that we did came four major changes to the Determination Letter Program that we are seriously looking into.

The first deals with interim amendments, which is probably the single most items of concern that we hear about from the Employee Plans community. That community has continually expressed the concern that interim amendments can cause increased costs to small employers and large employers alike. That they may be helping to not encourage employers because of these administrative costs to set up plans, that some employers may be dropping their plans; it's extra work and is it really that efficient?

We're looking at the interim amendments. The ACT recommended two approaches. First would be interim amendments would only be 411(d)(6) type amendments. In other words you would have to make them, if an amendment you made to a plan down the road could retroactively reduce a benefit. When Congress says so and under statutes that an amendment has to be made or such other items as the IRS, Treasury, Counsel, indicate should be made in a plan and the ACT also recommended that there be a notice requirement to employees if, in fact, an amendment is made to the plan or does not have to be made to the plan for several years until the filing deadline and we believe that it may not be a substantial amendment, but it wouldn't fit into the other categories that I just expressed.

We move forward and what we're trying to figure out on that is what would this notice be? We're trying very hard if we are going to have a notice requirement to use this change in the interim amendment rule to use a notice that's already in existence so there isn't any duplication of work necessary for the employer or the practitioner. Again this is in the discussion stage; we're not sure that we're going to go this way, but we're talking about it.

The second approach that the AC recommended was what they call core amendments where you'd only have to do an interim amendment for 4(11)(d)(6) statutory or if a core amendment, it's something that really affects an employee under the plan. The issue we would have there is how do you define core amendment? Again, there would be this notice requirement where we've gotten feedback from employer organizations about interim amendments and potential ways to approach them, make changes from individual employers, from individual practitioners and practitioner groups.

We are taking everybody's feedback under consideration and we'll continue to discuss this with the public to make sure that whatever we do is well thought out and will, in fact, work.

Another thing we're looking at is cutting back on the 5307s that we will accept – pre-approved plans. You have to wonder with every year we – every filing cycle even before staggered, we saw a decrease in the number of pre-approved plans coming in for determination letter because they were relying, in fact, on our opinion advisory letter as a determination letter, which is provided in our revenue procedure. So you start to wonder whether or not we should even be looking at these plans, some of these pre-approved plans. For example, Master Prototypes, where you can't make any changes to the document. We've already spent hundreds of hours looking at these plans, why are we spending more time looking at the individual plans? So there is some consideration given to not looking at what we consider to be these extremely low-risk cases.

Another thing we're looking at deals with demos, the demonstrations that come in voluntarily with the determination letter requests. We found that of all the demos there are only two principally being used. They are dealing with plan discrimination and operational discrimination and we're wondering whether or not we should even be looking at those demos except under circumstances where there is a real business necessity to do that.

It's a snapshot to begin with and it only looks at – well it doesn't only look at, but the primary purpose is to make sure that the methodology that is being used in the plan works. The question becomes should we continue to be looking at demos when demos came in at a time when we didn't have guidance about how to do testing. Now that this guidance is out, is it still necessary for us to be looking at them? So we're considering eliminating demos.

The final piece is some type of a uniform document where the provisions of the plan would follow in a uniform method. So, for example, the first section of a plan would be definitions. The second section would be participation requirements, and so on. I don't think we'll ever actually make that a requirement, but it certainly would help us get through your plans faster and it would be probably more as a request. We are looking at going back to the old requirement we used to have of having a check sheet of where things are in the plan if, in fact, you are not using that uniform requirement or even if you do use the uniform – uniform design and even if you don't.

Moving on let's talk about some specific areas that we're working on. One deals with 403(b) plans. We are still looking at and putting together materials to have a 403(b) Determination Letter Program. Our first focus will be that of the pre-approved plan. It is working our way through the review process – the LRMs are completed. The plan document is, rather the revenue procedure is completed; the LRMs are done as I said. We're asked, "Well, if the LRMs are done, why don't you issue them?"

Well, we don't issue LRMs when we don't quite have a revenue procedure out. We have to open a program before we can issue the LRMs. We're pushing hard to get this program moving. As far as individually designed 403(b) plans, that's something that we will – once we get this program open we'll then consider whether or not we have the resources to have an individually designed program open up down the road. It's definitely something that's still being considered.

Government plans – we get a lot of questions asked about the government plans and we are continuing to work those plans. We're hoping to have the majority of those cases that came in in cycle – well we have the majority out that came in in Cycle C, out the door relatively soon. There are about 400 to 500 cases in suspense pending guidance on a couple of issues. One dealing with normal retirement age and pre-risk investing for government plans and the second dealing with those plans that have government pick up arrangements.

Because what's been happening is some plans have been modifying their programs to give employees more choice in how much money they want to put in the plan in order to help cut costs in state plans and local plans – state and local government plans. What we're concerned about is that giving that choice could, in fact, result in employees having Cash or Deferred Arrangement – CODA. We are working on that issue to try to come up with some resolution.

Other areas of guidance we're working on – definition of government plan, the 414(d). Again, the definition of what a valid pick up arrangement would be for government plans and the non-governmental plan arena where we're continuing to work on hybrid plan regs. We're working very hard to move out regulations on multi-employer plans, particularly those rules surrounding what a valid rehabilitation is for multi-employer plans that get into distressed status.

The EPCRS, the new Rev. Proc., that is very far along in the clearance process. It's been drafted and we're ready to move it along to the next levels to hopefully get it signed and out. We have been working on a revenue procedure dealing with church plans and whether or not we will reopen our rulings program and under what circumstances we will reopen that program. We're looking to get that Rev. Proc. out in the very near future. It's extremely far along in the review process and we expect it out shortly. We're working to update our determination letter revenue procedure 2007-44. Not that should we make other changes after 2007-44 is updated we will come out with a notice basically stating or an announcement basically stating that this is what we're going to start doing from a certain point forward and when we come out with the next iteration of the Rev. Proc. we will then add these provisions into it.

The last piece of guidance that I think you'd be interested in hearing about deals with the 5500-EZ. We're establishing a late filer program. There was no such – there is no such program in effect as there is with the DOL and their late filer program. We're establishing one and we're very close to completion on that program. One question we're asked about is – we have an October 31st deadline for getting pre-approved plans in the lead plans for the next cycle of Defined Contribution Plans.

We recognize the fact that we haven't issued our LRMs yet because we're waiting for an update on the revenue procedure to reopen the program. We are very seriously looking at extending the filing date – extending that October 31st filing date to a later time. As usual, until something comes out, the official date is still October 31st. I would suggest that the sponsors are working on getting those plans updated so no matter what date we ultimately conclude is the correct date, they can be filed timely.

So that's most of what's going on – what we're working on in Rulings and Agreements. I'm going to let Vickie step in and talk more about the Determination Letter Program and when Vickie is done Keith Ruprecht will be updating you on what's happening in the Voluntary Compliance arena. Vickie?

V. Surguy: All right. Hello, everyone. I'm glad that you could join this conference. I'm going to take just a few minutes and cover some of the nuts and bolts about the Determination Letter Program, talk a little bit about our staffing, and about the customer satisfaction surveys.

The first thing I want to give out is – to make sure you have my e-mail address because there are many times when I know you all have questions that are very technical in nature and you may not – you do all the research and you look through the internet and the web and you still either have a question or you really just need to know something about a case that's in process. If you send me an e-mail I will probably not be able to answer it myself, but I will, as quickly as possible forward it on to the appropriate party who should be able to get back with you very, very quickly and answer your question.

As we go on and later on I will give you the site to go in, or the number to get to go in if you just have a status question. Other than that if it's not a status question and like I said, you've done everything and you can't find the answer, please feel free to send me an e-mail. My name is – and it's on the presentation there; it's Vickie and that's I-E and then dot and an A and then a dot, and my last name Surguy, S-U-R-G-U-Y at IRS dot gov (vickie.a.surguy@IRS.gov). Please feel free; I know how frustrating it is when you have a question that you just need answered and you can't find anybody to answer it.

Let's talk a little bit about customer satisfaction surveys. On every case that we close, not every case, but when we close cases through the DL process some cases are selected under a random sample for a customer satisfaction survey to go out. This is done by a private vendor that the IRS has working for them. A sample of these letters goes out and we ask questions about how the process went. I know just from human nature a lot of times you tend to answer more if you're dissatisfied. If you're satisfied sometimes you don't answer, at least I don't, I don't take the time to say, "Hey, they did a really great job." I just kind of throw it away, but if I'm very dissatisfied I do.

I'm happy to say that the surveys that we've gotten we do have some positive comments. We do have people that have written in and said, "Hey, your employees are very professional; they've done a great job; they were knowledgeable; they were helpful." We really enjoy seeing comments like that. Every comment that's sent – every verbatim comment is reviewed, not just at my level, but by the levels above. We're always looking for ways to improve it and we have a limited staff, which I'm going to talk about in a few minutes.

It's very important for us to read your comments. Sometimes it can even give us ideas on things that – where we need to improve. Now saying that we get positive comments, I also want to say we do get the negative comments. If you take the negative comments and sort of roll them up in a ball, what you have is pretty much titling us. "I sent my letter in" – or "I sent my application in and it took you a year to contact me. I never got an acknowledgement notice," things like that. Those are things that we're working on.

Also another one is "You need to let me know what's going on as far as the status of my case through the process." That's something else that we're looking at too. We have a team that's together that is management and management officials who are working on not only the EP Determination, but the EP Examination survey results and their verbatim comments and trying to make sure that we can make it better for you guys who are sending in applications and help us out, too. Please keep those surveys coming.

Now I promised you some nuts and bolts things. I want to let you know first that we do have a limited staff. My staff right now consists of 125 specialists who are either revenue agents or tax law specialist attorneys who review determination letter applications. When you think of the number of applications we get in, 125 individuals is not a lot to work with. They're scattered across the United States. I have 58 of those 125 who are the most experienced, who are able to do our most technical cases. For instance, they do work the demo cases. We also have some actuaries on staff that help us with the demos that we may be pulling apart from the determination process, as Andy discussed. They also do the ESOPs; they do cash balance; they do the most very complex, technical cases.

Then I've got 29, which isn't a whole lot, of kind of the middle of the road. They don't do the simplest, but they can't do the most complex. Some of those are working on our pre-approved plans, but more of the higher graded, the people who can do more technical work are also doing the pre-approved plans, but I only have 29 of those middle individuals. Then I have 34 that are more or less entry; they're newer agents or tax law specialists; they're just learning and they are not ready to do the more complex cases.

When you talk about 125 staff, like I said, that's not a lot to do the number of applications we have coming in. That's why we have to look at ways to improve it. Now, as I talk about that 125 staff, I want to let you know that 30 of those individuals are currently in class this week getting ready for those pre-approved plans, defined contributions that are coming in whether it's the October 31st deadline or whether it's the deadline later, you can probably guess we haven't gotten very many in yet since we don't have the guidance out yet, but we have them in training right now getting ready for those cases, so that takes 30 of my staff away right there, mostly of the higher graded and a few of those middle people.

We also have a cadre of individuals who work solely ESOP cases. Now this has been a dual edged sword for us. It's very good because we have a specific set of individuals working with most of those providers that send in ESOPs; they get to know the plans very well; they get to know – they can talk about the issues and so it leads for a lot more consistency where in the past they just kind of went to whoever needed cases. However, the other side of the sword is that as we have got into these plans we've found a lot more issues; we've found a lot of things where there really were unclear – guidance was unclear and we needed to get some guidance from Washington on those cases.

We have ESOP cases that we've had for an extended amount of time waiting for guidance. Most of the guidance, I think all of it, we have received and now we're working with the practitioner who submitted them to try to get those cases closed.

I also have a cadre, a group of people fenced off to do governmental plans because we found there is sensitivity with governmental plans, issues with those too, which Andy mentioned, and so we have a specific group doing those. We did have cash balance – a cadre, but most of the cash balance cases are closed. As you kind of hear that with my limited staff and all my cadres, and doing the pre-approved plans it doesn't leave a lot of people to do the regular cases, however, we're working our way in those.

If you look on page ten of the presentation you were sent, I give you a little history of what our inventory is right now. It says control date, and what control date means is the postmark date. That's the date that we actually go by when we're looking at how old our inventory is. The 5300s, mostly those are individually designed plans. Those are our most complex, those are usually ESOPs, the governmental plans, so that's why we have oldest date of '09 and I had the biggest amount of cases right there, over 6000 cases as of the 14th.

Of 5307s, there is 1000 there. Now some 5307s and their oldest control date, excuse me, is '08, but some 5307s are closed on the 61st day. We can't close a case until 60 days because of the Department of Labor regulation that says that we need to hold cases open from 60 days from its control date to wait for interested party comments. We don't get very many interested party comments; the most we every get is on 5310s, but it applies to all of our cases. We can't change that. We've talked about it, but it's something that we can't change.

Many 5307s are closed on that 61st day. Many of them we never make contact on. That's why we're looking at trying to limit those even coming in the door more because they don't need to be mailed to us, processed to us, but we're working on ways to better have the opinion and advisory letter identified with the case so that banks, insurance companies, different individuals feel they can rely more on that letter. Then 5310s are our highest priority. They're always on cycle so we don't have too many of those, and 5316s those are pulled ... a new application form, and we don't get very many of those cases, either.

All right, now I want to take you to page 29 of the presentation. The reason I'm taking you there is because we get a lot of requests for letter corrections and this page gives you the information on what you need to know if you need to get a letter corrected. If you have a data wrong, a name wrong, anything, you entered the information wrong, this is what you need to do just follow the guidance there and that will help you with letter correction.

Now all of this information in between from page ten to page 30, this is really how to fill out your application and get it in. If you follow these procedures when you're filling out your applications and sending them in to us, this is your guide then, everything, your do's, your don'ts, the nuts and bolts of getting your application in. I don't really need to cover it word for word, but just read it. Use it as a reference guide and your application should be processed through our determination letter process much easier.

Now the last page of the PowerPoint that I want to talk about is page 30, and on page 30 it gives you the web site, which John discussed earlier. I told you I was going to give you the number for the status checks, that's right there under the toll-free. That's just really for the status checks.

Then we have our Annual Rev. Proc.-6 we're working on 2012-6. We will have some changes in it, make sure you stay tuned and look at it. Some of these things that Andy was talking about that were developments where we want to change the program; some of those will be listed in there. Make sure every year you review -6, because every year there could be changes to the determination letter process in there.

We're also going to try to come out with soft guidance, newsletters, other articles, special announcements to changes, but make sure you always look at -6. The user free Rev. Proc. is -8, make sure you look at that too. Andy already talked about 2007-44 that that's going to be modified and when we're looking at Cycle A-squared now and what we will come out with modifications to that and we also will come out with some other guidance.

I had one question submitted to me in advance that I did want to cover and someone wants to know really how should they verify prior law when they send in the application? Since we're in A-squared what you'll need to do is send in proof that you had a letter under the first set of the cycle. If you're coming in under Cycle A now you want it to have a letter where it shows the cumulative list for 2005 and it was under the first cycle, which ended on January 31, 2006. What we're going back is one law. Other than that, that's everything I have and I'm going to turn the presentation over to Keith.

K. Ruprecht: Thank you. Good afternoon. My name is Keith Ruprecht. I am the Manager of VC Groups 7553 based in Dallas. I currently have 13 agents working for me in various cities. I will be discussing some common application issues we see in Voluntary Correction cases. I will discuss the failure, recommend methods for correcting the problem, and also give you some tips on how to avoid these failures.

Included in the PowerPoint presentation are links to various sources on the IRS internet site. Some of these links will take you to the newsletter that was already previously discussed, *Retirement News for Employers* and also to the 401(k) fix it guide, which is only one of several guides available to the public.

In addition, our current revenue procedure for Employee Plans, Compliance Resolution System, or EPCRS, RP 2008-50, has multiple examples and explanations of correction techniques for various failures.

So I first want to talk about improper loans. Many employers make participant loans available in their retirement plans. When a plan makes loans available one important statutory requirement is to consider §72(p) dealing with taxability of participant loans. A plan loan is a taxable distribution, unless the loan satisfies the exceptions under §72(p)(2), which sets limits on the amount of a non-taxable loan and the repayment of the loan.

The most common plan loan failures relate to loans that exceed the maximum dollar amount, loans with payment schedules that don't meet the time or payment limit, and defaulted loans due to failure to make required payments. Each of these will cause the loan, or portion thereof, to become a deemed distribution for tax purposes.

A deemed distribution differs from other distributions in that the participant is taxed as if the distribution were received, but the treatment of the loan as a distribution does not excuse the participant from the obligation to repay the loan.

I just want to quickly go through an example and show you how an error occurs, how you can find it, and how you can correct it, and perhaps not ever encounter the problem again. For example, a 401(k) plan permits participants to take loans. The plan sets forth the loan limits of Code Section 72(p)(2) so that a loan for a plan participant will not be treated as a distribution to the participant.

Let's say that on June 1, 2009, Jane took a $10,000 loan from her employer's 401(k) plan. Her loan was for a five-year period and required monthly payments of $203. Her loan payment was to be made by payroll withholding. The plan did not provide for a cure period for missed installments. Paychecks are issued at the beginning of the month. Jane's loan information was not forwarded to the Payroll Department and as a result, no payments were withheld in 2009.

The problem was discovered on December 15, 2010 during an annual review of the plan's records. July 1, 2009, then, would be considered to be the first missed payment and her outstanding loan balance of $10,067, which is the loan plus accrued interest, would be treated as a deemed distribution. Jane is required to report the $10,067 in income on her 2009 Form 1040.

Now, how can we find a mistake like this when it happens? At the beginning of each month, the plan should reconcile the aggregate payroll deposits to the plan (employee's elective contributions, and loan repayments), with the payroll amounts that should have been deposited to the plan in this example including Jane. If there are gaps in payroll records, election forms and loan documents should be analyzed on an individual basis to determine whether the correct amounts, including loan repayments, were withheld from the employee's paychecks and deposited into the plan.

How to fix the mistake. A loan's outstanding balance will be a deemed distribution to the participant, if the plan does not receive a required loan payment by its due date. To remedy this, the employer may request and obtain relief from the IRS under the Voluntary Correction Program, or VCP. In order to obtain relief, the mistake must be corrected.

In our example, if the failure was corrected on January 1, 2010, which is basically the first day of the next year after this happened, the plan administrator would have to ask Jane, the participant, to do one of three options: make a lump sum payment for the six missed installments adjusted for interest and continue making the same installment payments for the remaining period of the loan; or you could re-amortize the outstanding the balance of the loan, resulting in increased installment payments for the remainder of the loan period; or you could make a partial lump sum payment, amount less than the six missed payments adjusted for interest, and re-amortize the outstanding balance of the loan, resulting in a monthly payment that is higher than the original amount.

You'll notice from these three correction techniques that it is very important to find the mistake before the period of the loan is completed. Once you're outside of the normal loan payment period, you cannot go back and make these adjustments and save your participant from having to have a deemed distribution. That's why, again, it's very important to find these errors early and to get them corrected.

Now, two ways you could have avoided this mistake under the fact pattern we were talking about, you could require transmittal of loan information to payroll before making a loan. The plan should institute procedures that would include evidence of receipt of the loan information by the Payroll Department before a check is issued for the loan. For example, procedures could provide that an application form that has been reviewed and approved by the plan administrator must be initialed by an authorized individual in the Payroll Department before a check for the loan is issued.

Again, another technique would be that the plan could permit a cure period. A plan may provide that a loan does not become a deemed distribution until the end of the calendar quarter following the quarter in which the payment was missed. A cure period gives the plan administrator time to take corrective action without negative consequences.

In our example, if the plan administrator had followed such a procedure then upon discovery in December 15, 2009, the plan administrator would have had the opportunity to secure the missed payments from Jane and prevent the loan from being treated as a deemed distribution. The first missed payment that was due on July 1, 2009 could have been secured as late as December 31, 2009. That's one example of a very common error that we see with loans and you want to come in and try to get the deemed distribution problem taken care of so your participant doesn't have to suffer that loss.

I want to move on now to 401(k) testing and deferral errors. I have two different examples here. I think we have time for both of them. The first one I want to talk about is failure to effect employee deferral elections. An employer's failure to execute an employee's election to defer amounts to a 401(k) plan is a relatively common error. Like its cousin, mistakenly excluding an employee from a plan, the problem can be rectified by making a qualified non-elective contribution, also known as a QNEC, to the plan on behalf of the employee. As in the case of other operational problems, the error can be fixed through EPCRS.

The problem to address is one of the missed deferral opportunity. The employee received taxable compensation instead of being able to defer amounts on a pre-tax basis and to accumulate earnings on the deferred amount tax-free until qualified distributions are taken. Let's look at an example. Now, these examples don't include catch up contributions for people that are 50 or older, after-tax contributions, or designated ROTHs, which would greatly complicate the example. Those do have to be taken into account, but we're going to keep this example as simple as possible.

Also, the employee's a non-highly compensated employee or NHCE.

Avaneesh's elective deferral election at the start of 2006 somehow was never processed by the employer's payroll system. As a result, Avaneesh received taxable compensation amounts that should have been contributed to the plan during the first six months of the year. Avaneesh's election form selected a deferral of 10% of pay, so it's important here to note that the participant did make an election and chose a percentage.

The remedy of this situation requires the employer to make a corrective contribution of 50% of the missed deferral adjusted for earnings on behalf of the effected employee. The employee is fully vested in those contributions, which are subject to the same withdrawal restrictions that apply to elective deferrals. The employee's election deferral amount is known, thus the missing deferral and the corresponding corrective contribution, in other words, 50% of the missing deferral, are based on the participant's actual election.

If Avaneesh had been excluded from the plan and had not made an election, the correction would have to be based on the ADP for his employee category. In this case, he's a non-HCE, so that's an important thing to know in these correction mechanisms. If the employee makes the election, that's what you use. If not, then you go ahead and use the class one.

Okay. The missed deferral amount should be reduced, if necessary, to ensure that the employee's elected deferral, the sum of the deferral is actually made and the missed deferral for which a corrective distribution may be required, comply with other applicable plan and plan limits, for example, 402(g).

Now, on the flip side on this, you have the possibility of a 401(k) plan having excess deferrals. The Internal Revenue Code imposes a limit on the maximum elective deferrals that an employee can make each year to a qualified plan. This includes elective deferrals under 401(k) arrangements, including simple 401(k), and Safe Harbor 401(k) plans, 403(b) plans, and simple IRAs. Making deferrals in excess of the legal limits is one of the top ten issues identified during examinations of 401(k) plans.

The elective deferral limit is a flat dollar amount that is subject to annual cost of living adjustment. Employees whose elective deferrals exceed the limit must report the excess as income on their tax returns for the calendar year the deferral was made and on their tax returns for the calendar year when the excess amounts are withdrawn. If elected deferrals all from the same employee exceed the limit, the plan is disqualified. The only way to correct the mistake and avoid double taxation and potential plan disqualification is to have the excess amount plus earnings refunded to the employee for the tax filing deadline for the year in which the deferrals were made.

The deferral limit is applied on an aggregate basis to elective deferrals made under all plans maintained by the employer. The employer is responsible for determining whether a participant has excess deferrals under all the retirement plans it maintains. However, excess deferrals by participants will not disqualify the plan if the excess is due to the aggregation of the participant's deferrals to a plan maintained by an unrelated employer. And we also have to note that the entire plan, not just the 401(k) arrangement, is disqualified for violations of the deferral limitation.

Common causes for elective deferral failures include the failure to monitor limitations for each employee, limitations based on the calendar year, and employees who transfer between divisions or plans of the same employer. Again, as we said before, violation of the elected deferral limitation by a plan will cause the plan to become disqualified, resulting in adverse tax consequences.

You can get relief through EPCRS by correcting the failures. The Self-Correction Program, or SCP, or the Voluntary Correction Program, VCP, can be used to correct these mistakes. In order to fix the mistake under SCP, generally, the mistake must be fixed within two years after the end of the plan year in which the failure occurred. Unless the failure can be classified as insignificant, VCP must be used after this time.

Under EPCRS, the plan may avoid disqualification even though the plan has failed to correct excess to deferrals by the April 15 deadline. The permitted correction method is distributing the excess deferrals to the employee and reporting the amount as taxable income in the year of deferral and in the year distributed. Thus, if the corrective distribution is made later than April 15 deadline, the employee will be subject to double taxation on the excess deferral. EPCRS does not provide relief from this double taxation.

To make sure this doesn't happen, employers need to ensure that they have a system in place to monitor salary deferrals for the employees who participate in more than one plan of the employer. The employer should work with plan administrators to ensure that the administrators have sufficient payroll information to verify the deferral limitations were satisfied. Employers may wish to remind plan participants that monitoring deferrals for multiple employers is the participant's responsibility.

Now I'd like to move onto, again, a very common error. I close cases all the time and sometimes I'll have ten cases in a row that deal with plan compensation errors. So why is using the correct definition of compensation important? Use of incorrect compensation is one of the most common errors found on IRS plan audits. Compensation errors can often be self-corrected if discovered internally.

Important areas where compensation is used from the plan document include top-heavy minimum contributions, the limitations under Section 415, highly compensated employees, key employees, leased employees, allocations of plan contributions, non-discrimination testing, and deductions. Realize that for many of these different areas you may have a slightly different compensation definition.

Some instances where problems can occur are unfamiliarity with compensation definition, Plan document provider changes the definition of compensation and the old compensation definition is not compared with the new document and then sent to the payroll system for changes. or the employer added a new element of compensation but did not check to see how it was treated under the plan.

Here is an example that you see all the time. A participant receives a bonus for perfect attendance. This bonus for perfect attendance is part of the W-2 income and the plan defines compensation as being W-2 pay but no deferrals or matching contributions were made. The correction would be similar to the examples we've talked about before of deferral errors where the employee has to have made an election, i.e. the 50% amount with earnings.

Some other examples of how compensation errors occur, the payroll provider has been changed and items are discovered to be coded incorrectly in the previous system or they're coded incorrectly in the transition to the new system. Also, newly acquired plans, very often I know you're busy when you're acquiring a new plan and you're setting everything up, but you've got to realize that the payroll systems are different and they might be accumulating compensation amounts differently.

Now I also want to talk about PPA Section 1101 and excise taxes. This is a very common question that we get and also we have some problem with applications because people try to use this provision of the law to ask for things that we cannot do at this time. So, let's talk about what PPA states, and this is the Pension Protection Act and this is under Section 1101.

So, what does PPA state about EPCRS? It reads, "In general, the Secretary of the Treasury shall have full authority to establish and implement the employee plans resolution system or any successor program and any other employee plans correction policies, including the authority to waive income, excise, or other taxes to ensure that any tax, penalty, or sanction is not excessive and bears a reasonable relationship to the nature, the extent, and the severity of the failure." So, again, it's giving us very broad authority to use this program to cover a variety of issues.

A question we've often gotten since this was enacted is, "Can I request relief from certain excises taxes using the EPCRS?" Well, the answer to that question is yes. Appendix D to the revenue procedure lists the excise taxes that can be potentially relieved by use of EPCRS. They include Sections 4972, 4973, 4974. 4979, and to a certain limit, Code Section 72(t).

Now, for 72(t), it is limited to the excise tax that would be imposed on a taxpayer who received an overpayment, rolled it over to an IRA, and then as part of the correction provided for the direct transfer of the overpayment from the IRA back to the plan. It only effects the early withdrawal penalty that would be applicable to the distribution from the IRA.

It's important to remember that EPCRS is a formal administrative program of the service. Relief can only be made for issues specifically authorized in the revenue procedure for EPCRS and in other formal guidance. Applicants cannot request relief for errors or taxes not discussed in these documents. The revenue procedure does include an address where the public can send suggestions for improvement, such as adding new errors or taxes into the program.

Again, a lot of people who read that in the law and think that, "Well, I'm going to come in and ask for a certain tax to be waived or a certain situation that we don't really cover yet." We can't help you in that case. We'd have to send the application back to you, but we are very interested in areas that you think we should be getting into or that we should look into for inclusion into our program in the future years. Again, there's that address you can use to send in stuff to us.

Some current hot issues, we're integrating voluntary compliance and determination letter programs somewhat. We're working on a standard application form, which can be used for submitting voluntary correction cases more efficiently by using some of the processing infrastructure already being used by determinations.

In addition, we are processing VC cases and then forwarding associated determination letter cases to determinations for processing, so we're sort of splitting the load and that sort of speeds our process up. We are also experimenting with cross-training some determination personnel who could complete both the voluntary correction and determination part of certain cases. Again, we're trying to be as efficient as possible and to use a lot of the infrastructure that determinations already has to make our cases flow smoother.

Andy and other people have mentioned the upcoming revenue procedure for EPCRS. This will include procedures for errors with plan documents and problems for 403(b) plans, and as Andy said, this is pretty close to coming out. That's probably the biggest change that's in that revenue procedure.

One other thing I want to talk about is the Voluntary Compliance Satisfaction Survey. We are currently including a survey form with random closed cases. The survey has just eight questions and space for suggestions to improve our program. If you receive one with your correction statement, please take the time to complete the form.

That concludes my presentation. I would like to thank you for your interest in our program.

Moderator: And ladies and gentlemen, that does conclude today's conference. Thank you for your participation and for using AT&T TeleConference Service. You may now disconnect.