



# Self Correction Program (SCP) and Closing Agreement Program (CAP)

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# Agenda

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- ❑ Current examination issues found in SCP and CAP cases.
- ❑ Procedures and requirements for participating under EPCRS during the examination process.
- ❑ How CAP sanctions are determined and negotiated under Audit CAP.

# Current examination issues found in SCP and CAP cases – All Plans

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- ❑ Non-Amenders
- ❑ Definition of “Compensation”
  - ❑ Plan vs. operational definition not consistent
- ❑ Excluding eligible employees / Including ineligible employees
- ❑ Plan loans
  - ❑ Sponsor: failure to withhold loan payments

# Current examination issues found in SCP and CAP cases – 401(k)/(m)

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- ❑ Employer matching contributions not made
  - ❑ Failure to properly count Hours of Service
  - ❑ Incorrect plan entry date
- ❑ ADP and ACP testing failures
  - ❑ Not completed
  - ❑ Not passed
- ❑ Excess elective deferrals
  - ❑ Limit increased from \$16,500 to \$17,000 for 2012

# Current examination issues found in SCP and CAP cases – 401(k)/(m)

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- ❑ Late deposit of 401(k) deferrals
- ❑ Failure to use correct compensation
- ❑ Improper exclusion of eligible employees for purposes of ADP and/or ACP testing
- ❑ Misclassification of Highly and Non-highly Compensated Employees for purposes of ADP and/or ACP testing

# Current examination issues found in SCP and CAP cases – 403(b)

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- ❑ Excess elective deferrals
  - ❑ Improper use of the 15 year-of-service catch-up rules
- ❑ Universal availability
  - ❑ Exclusions
    - ❑ Part-time employees
    - ❑ Other arbitrary classifications
    - ❑ Reclassifying independent contractors



# Current examination issues found in SCP and CAP cases – MAP

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- ❑ Participation Agreement
- ❑ Benefit Calculations/Crediting Service
- ❑ Funding Deficiencies Exclusions
- ❑ Post - Normal Retirement Date Payments & Actuarial Adjustments



# Current examination issues found in SCP and CAP cases – IRS.GOV

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- ❑ Fix-It Guides - Common Problems, Real Solutions
  - ❑ 401(k)
  - ❑ IRA base plans – SIMPLE, SARSEP, SEP
- ❑ IRC 403(b) Tax-Sheltered Annuity Plans - Correcting an Eligibility Failure Due to Loss of Tax-Exempt Status





## Procedures and requirements for participating under EPCRS during the examination process.

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- ❑ Current Revenue Procedure: Rev. Proc. 2008-50 (generally effective in January 1, 2009)
- ❑ Expected update TBD
- ❑ Primary Purpose: Update to reflect the written plan requirement under the final 403(b) regulations



## Procedures and requirements for participating under EPCRS during the examination process.

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- ❑ EPCRS consists of three correction programs
  - ❑ Self-Correction Program (SCP)
  - ❑ Voluntary Correction Program (VCP)
  - ❑ Audit Closing Agreement Program (Audit CAP)

## Procedures and requirements for participating under EPCRS during the examination process.

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- ❑ Should restore the plan to a position it would have been if the failure had not occurred.
- ❑ Should be reasonable & appropriate
  - ❑ Keep assets in trust
  - ❑ Shouldn't violate another Code section
  - ❑ Should give NHCE benefits if 401(a)(4) violated
- ❑ Same method should be applied to all years
- ❑ Corrective allocation should be based on Plan and come from employer contributions  
& include Gains/Losses (earnings)

## Procedures and requirements for participating under EPCRS during the examination process.

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- ❑ Appendix A sets forth Operational Failures and Correction Methods relating to Qualified Plans. Corrections are acceptable under SCP and VCP.
- ❑ Appendix B sets forth correction methods for operational failures along with acceptable earnings adjustments.
- ❑ Appendix A/B corrections are deemed to be reasonable.
- ❑ These corrections and earnings adjustments may also be used for correction under Audit CAP with the Area Coordinator's concurrence.



## Procedures and requirements for participating under EPCRS during the examination process.

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### ☐ Self-Correction Program

- ☐ Available at any time to correct insignificant failures.
- ☐ Must have established compliance practices and procedures.
- ☐ No fee or sanction required.



## Procedures and requirements for participating under EPCRS during the examination process.

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### ☐ Self-Correction Program

- ☐ Operational Failures (that are not egregious) only
- ☐ Practices and procedures
- ☐ 2 year limit if failure is significant

## Procedures and requirements for participating under EPCRS during the examination process.

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### ❑ Self-Correction Program

- ❑ Insignificant failures can be corrected at any time
- ❑ Limited use of correction by plan amendment.
- ❑ Egregious failure examples:
  - ❑ Plan only covers HCEs
  - ❑ Plan provides HCEs benefits that are several times 415 lim.



## Procedures and requirements for participating under EPCRS during the examination process.

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### ❑ Self-Correction Program

- ❑ The operational failure (even if significant) must be corrected and the correction is either completed or substantially completed by the last day of the **correction period**.



## Procedures and requirements for participating under EPCRS during the examination process.

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- ❑ Self-Correction Program - Correction period
  - ❑ Generally the last day of the correction period is the last day of the 2<sup>nd</sup> Plan year following the year for which the failure has occurred.
  - ❑ Exception – failure to satisfy IRC section 401(k)(3), 401(m)(2) or 410(m)(9) which are allowed the additional correction period permitted under IRC section 401(k)(8) or 401(m)(6).



## Procedures and requirements for participating under EPCRS during the examination process.

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- ❑ Self-Correction Program - Correction period
  - The correction period for an operational failure that occurs for any plan year ends, in any event, on the first date the plan or Plan Sponsor is **under Examination** for that plan year.

## Procedures and requirements for participating under EPCRS during the examination process.

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- ❑ Self-Correction Program
  - ❑ Substantial completion of correction requires that either paragraph (1) or (2) below are satisfied:
    - ❑ (1) within 120 days after the last day of the correction period, the Plan Sponsor completes correction; or
    - ❑ (2) during the correction period, correction is completed with respect to 65% of all affected participants.

## Procedures and requirements for participating under EPCRS during the examination process.

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- ❑ Self-Correction Program - Four Instances where SCP can be used to retroactively amend the plan:
  - ❑ I.R.C. 401(a)(17) - The other employees receive an additional allocation equal to the HCE % using (a)(17) compensation.
  - ❑ Hardship Distributions - Allows sponsor to adopt amendment for hardships in case where they were allowed but the plan did not provide for them.

## Procedures and requirements for participating under EPCRS during the examination process.

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- ❑ Self-Correction Program - Four Instances where SCP can be used to retroactively amend the plan continued:
  - ❑ Loans – Same as hardship distributions
  - ❑ Inclusion of Ineligible Employee - Allows employer to adopt amendment allowing these specific employees to enter early [as long as IRC section 401(a)(4) is satisfied].



## Procedures and requirements for participating under EPCRS during the examination process.

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### ☐ Self-Correction Program

- ☐ Self-correction available only if plan has practices and procedures reasonably designed to promote compliance
- ☐ Plan document not enough



## Procedures and requirements for participating under EPCRS during the examination process.

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### ☐ Self-Correction Program

- ☐ Doesn't have to be formal
- ☐ Generally should be in place before failure
- ☐ Operational failure should have occurred because of oversight or mistake in applying procedures

## Procedures and requirements for participating under EPCRS during the examination process.

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- ❑ VCP - Voluntary Correction with Service Approval
  - ❑ Plan Sponsor, at any time before audit, may pay a limited fee and receive the Service's approval for correction.
  - ❑ Under VCP, there are special procedures for anonymous submissions and group submissions.
  - ❑ An anonymous VCP submission does not protect a Plan Sponsor from a subsequent Examination.



## Procedures and requirements for participating under EPCRS during the examination process.

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### □ Audit CAP

- IRS discovers failure (usually upon IRS audit; sometimes in DL application review) and offers resolution by closing agreement.
- Conditions for closing agreement:
  - Correction of failures
  - Payment of sanction
- Benefit: Plan's qualified status preserved.

## Procedures and requirements for participating under EPCRS during the examination process.

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### ❑ Audit CAP

- ❑ The sanction will bear a reasonable relationship to the nature, extent, and severity of the failure, taking into account the extent to which correction occurred before audit.
- ❑ Nonamender failures are not eligible for SCP and must be corrected under Audit CAP.
- ❑ Generally, Audit CAP is only offered at the time of the Employee Plans examination.

## Procedures and requirements for participating under EPCRS during the examination process.

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- ❑ Audit CAP - Significant vs. Insignificant Operational Failures
  - ❑ The number of failures in each year
  - ❑ % of assets & contributions involved in the failure
  - ❑ Number of years affected
  - ❑ Number (& %) of participants affected
  - ❑ Was the violation corrected
  - ❑ Reason for the error

# Procedures and requirements for participating under EPCRS during the examination process.

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## ADP test failures examples –

- ❑ Insignificant – 1 year failure due to the misclassification of an HCE
- ❑ Significant – 4 year failure of the same misclassification not identified until the Revenue Agent reviews the testing and identifies the error.
- ❑ Significant – ADP testing not performed and, when performed at the agent's request, failed.

## Procedures and requirements for participating under EPCRS during the examination process.

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### Vesting failures examples –

- ❑ Insignificant – Erroneous vesting calculation for 1 terminated employee.
- ❑ Significant – Same failure for a number of years. It would still be significant even if only 1 terminated employee if 100% of the vesting calculations done over a number of years were incorrect.



## Procedures and requirements for participating under EPCRS during the examination process.

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### Erroneously excluded employee failure examples

- Insignificant – 1 employee excluded from either a profit sharing contribution and/or making elective deferral (could be for more than one year).
- Significant – Multiple employees excluded, especially a specific group of employees, such as part-time employees or employees from a certain employer within a controlled group.



## How CAP sanctions are determined and negotiated under Audit CAP

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- The sanction under Audit CAP is a negotiated percentage of the Maximum Payment Amount (Rev. Proc. 2008-50, Section 14.01)



# How CAP sanctions are determined and negotiated under Audit CAP

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- ❑ Equities of the Employer
  - Overall practices and procedures are in place.
  - Proper and timely testing procedures.
  - Overall involvement of the Employer in the Plan operation.
  - Financial condition of the Employer.



# How CAP sanctions are determined and negotiated under Audit CAP

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- ❑ **Maximum Payment Amount** -A monetary amount that is approximately equal to the tax the Service could collect upon Plan disqualification –
  - tax on the trust (Form 1041);
  - additional income tax resulting from the loss of employer deductions for plan contributions; and
  - additional income tax resulting from income inclusion for participants in the plan, including distributions that have been rolled over to other eligible retirement plans



# How CAP sanctions are determined and negotiated under Audit CAP

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- Additional Factors Considered in the Determination of a Sanction under EPCRS
  - Each case is based on a unique set of facts and circumstances including:
  - Strength of the Employer's Internal Controls
  - Size of the Employer
  - Number and type of participants impacted (HCE's vs. NHCE's)

# How CAP sanctions are determined and negotiated under Audit CAP

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## □ **Sanctions for Non-Amender Issues**

- A fee schedule applies to “non-amender” issues discovered during the Determination letter process (found in Rev. Procs. 2006-27 and 2008-50, Section 14.04)
- If one of the failures discovered during an Employee Plans examination includes the failure to amend the plan timely for relevant legislation, it is expected that the sanction will be greater than the applicable fee described in section 14.04 (new to Rev. Proc. 2008-50).

# How CAP sanctions are determined and negotiated under Audit CAP

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## □ **Negotiating the Sanction**

- Begin discussing the EPCRS process with the agent as soon as an examination is substantially completed.
- If there are equities and/or mitigating circumstances you wish to have considered, submit them in writing to the agent during the negotiating process.
- If negotiations with the agent break down, request a conference call with the agent and the agent's manager.

# How Can I Find Out More?

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[www.irs.gov/ep](http://www.irs.gov/ep)



**Newsletters**

**Employee Plans News**

**Retirement News for Employers**

**Governmental Plans Update**