Transcript for EPCRS Phone Forum

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Moderator: Ladies and gentlemen, thank you for standing by, and welcome to the EPCRS Phone Forum. As a reminder, today's conference is being recorded. I would now like to turn the conference over to your host, Mr. Mark O'Donnell. Please go ahead, sir.

M. O'Donnell: Hi, everyone. I'm Mark O'Donnell, Director of Customer Education and Outreach for IRS Employee plans. Welcome to our EPCRS Phone Forum. Today we'll be hearing from Avaneesh Bhagat, Voluntary Compliance Group Manager, and Stephanie Bennett, Voluntary Compliance Tax Law Specialist. Both are involved in reviewing and resolving submissions under the Voluntary Correction Program.

Before we start, I'd like to point out a couple of things. Everyone registered for this forum 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 credits 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 the Employee Plans Voluntary Compliance Program, please visit the retirement plans website at www.irs.gov/ep. You can also get there by going to the main IRS webpage and clicking on the Retirement Plans Community tab along the top. Look to the left-hand navigation bar and click on Correcting Plan Errors. While visiting our website, you might also want to subscribe to our free electronic newsletters. The link for newsletters is also in the left-hand navigation bar. We have two newsletters, the Retirement News for Employers is for small employers sponsoring a retirement plan, and the Employee Plans News for retirement plans professionals. So without further ado, here are Avaneesh Bhagat and Stephanie Bennett.

A. Bhagat: Hello, everybody. Thank you for your participation in this forum. The plan is that we'll start briefly with the Power Point slides. I hope all of you have—were able to access those successfully. And then, we'll move from that pretty quickly and get to the questions submitted by you all for the forum, and we would like to thank you for the questions that you put forth before us, so there's a good variety. And so, we'd like to get to them reasonably quickly.

And then, after that, if time permits, we'll get back to the issues, some of the issues discussed in the slides, but you'll find that the slides are pretty self sufficient. Just to give you an overview, the first 21 slides discuss the correction programs that form EPCRS, the Employee Plans Compliance Resolution Systems. After that, slides 22 through 28 deal with issues related to 401(k) plans, finding, fixing and avoiding mistakes relating to 401(k) plans. And then after that, from slide 29 onwards, there's a discussion of selected correction issues in more detail. The summary of those correction issues can be found in slide 29. Then after that, the discussion follows from slide 30 onwards, pretty much to the end of the Power Point presentation. And so, you'll find that the presentation is pretty self contained, and I hope you find the information useful.

One of the things that, I think, before we get to the questions is I want to address the basic question as to what the rules of the game are and when do we expect changes. The current revenue procedure governing our correction programs is Revenue Procedure 2008-50, and throughout this presentation, you'll hear us refer to the acronym Rev. Proc. Rev. Proc. will always stand for Revenue Procedure 2008-50 throughout our discussion in this presentation.

And so, the question that comes up is—commonly comes up is when is the next Rev. Proc. going to get issued, and what can we expect from that. All we can say at this point is that the expected update will come in the future, hopefully the near future. And the primary purpose of that update is to reflect the written plan requirement under the final 403(b) regulations. So, but until that point, as you all probably have discovered through the VCP submission process, there are certain limitations that we have to operate under certain things under 403(b), we can cover, certain things we can't cover. And some of that actually will be fleshed out in the question and answer session.

What I want to do before we move to the questions and answers is set up a little bit of a foundation because I realize there are people of all backgrounds coming into the forum. So, if you look at slide six, that talks about the EPCRS correction programs. Those are the three programs that form the Employee Plans Compliance Resolution System, and the rules for that are covered in Revenue Procedure 2008-50. So basically, there are three programs: the Self-Correction Program, which enables you to correct certain problems on your own without actually getting formal IRS approval for it; then you have the Voluntary Correction Program, which entails a formal application and a payment of a fee to the Service, where the plan sponsor identifies a problem and proposes a correction to the Service, and upon approval, the IRS issues

a compliance statement. And the advantage of that compliance statement is that if your plan was to be audited in the future, assuming the facts were correct, that compliance statement protects you from plan disqualification for the particular issues that are covered under that compliance statement. And finally, there's the Audit Closing Agreement Program, which basically provides

the vehicle for plans to correct problems when the plan is actually under IRS examination. So, those are the three programs, and the goal of all of these three programs is to preserve the tax deferred benefits for participants, basically to preserve the tax-favored treatment that these plans are able to take advantage of. In addition to that, in certain very limited situations, some income tax and excise tax, there may be relief for certain income tax and/or excise tax issues. It's a limited relief, and you can refer to the slide for the areas where that relief may be possible.

Then the next slide, which is slide seven, in essence, gives you the framework under which if you have a problem, that's the framework that you would use to figure out how you would fashion a correction once you determine that a problem exists. And the framework is referred to in the revenue procedure as the correction principles. You'll find that the principles themselves are pretty commonsensical. For example, one of the principles entails that you need full correction of the problem. It includes correction for all taxable years, whether or not the statute of limitations has run out or not. That's not a limitation as far as correction goes. So, let's say you have a problem that's occurred for the past ten years. You need to correct that problem for the past ten years. You can't use the statute of limitations as a basis for limiting the scope of your correction.

In addition to that, another correction principle is that the correction method should restore the plan and its participants to the position they would have been had the failure not occurred. And it's a pretty commonsensical principle because you would basically—what that does is it says where would the plan have been had the failure not occurred. Where is the plan now? And then, you try to fashion a correction that would basically bridge the gap. Another criterion is that the correction, whatever correction you fashion, should be reasonable and appropriate for the failure on hand. To assist with that, there are Appendices A and B at the end of the revenue procedure, and they have certain common failures and certain particular fixes that if you follow those, you have deemed reliance on those fixes. You don't have to worry about whether those solutions work.

However, there could be times where you could have a situation that's not covered in those appendices, or even if that situation is covered under those appendices, you may want to come up with a different correction other than those provided in Appendices A and B. So in that case then, the expectation would be that whatever correction you fashion should be reasonable, and the revenue procedure provides certain guidelines under the correction principles to help you come up with a reasonable solution. Examples of that would be that the corrections should generally comply with what's in the Internal Revenue Code and related regulations. But if you have different options, you should probably choose the correction method that provides meaningful benefits to the non-highly compensated employees, and wherever possible, you want to keep assets in the plan.

So, that's the framework under which these programs operate. And so, what I'd like to do now is shift gears and get to the questions, and what I'm going to do is—basically, I've taken the questions that have been submitted by you, and I'm going to ask these questions, and my co-presenter, Stephanie Bennett, who has done tremendous amount of work in terms of researching the answers and coming up with the answers to these questions, so it's going to be a Q&A format where I'll ask the question and Stephanie would provide the answers. So, welcome to the presentation, Stephanie, and let's start.

The first set of questions are related to 403(b) plans, and actually with these questions, you'll get an idea of what things we are able to address in the revenue procedure currently and what things we can't. So, the first question is: Question one, if a 403(b) sponsor has no written plan, how do we correct?

S. Bennett: Well, under the current revenue procedure, a plan sponsor is not eligible to correct a failure to timely adopt a written plan. Those VCP submissions are treated as ineligible submissions and will be returned along with the submission fees. The current draft of the next version of the revenue procedure will open up the program to allow for the correction of plan document failures in 403(b) plans. But at this point, we would suggest that the plan sponsor adopt a written plan now, and then go ahead and submit under VCP once the new revenue procedure is issued.

So, just by way of background, Section 5.02 of the revenue procedure outlines the failures that are eligible for correction under the program currently. Those failures include operational, demographic and employer eligibility failures. For example, the failure to satisfy the requirements of code sections 403(b)(12)(A)(ii), relating to the availability of salary reduction contributions, often referred to as universal availability requirements, that's an operational failure and is eligible for correction under the program.

A. Bhagat: And actually if you go through Section 5.02, you'll find that the things that you're able to address are basically specific statutory violations of Sections 403(b). So for example, if you have a violation of 403(b)(12) relating to the universal availability requirement, that's something you could address, and there are other examples, such as if the plan failed to comply with the distribution restrictions for 403(b) plans, under 403(b)(7) or 403(b)(11), or you consider compensation in excess of a 401(a)(17) limit, various statutory rules, if you're violating those, those are the kinds of things that you can address now under the revenue procedure. What you can't address, obviously, is plan document failures and there are certain other things also that—certain other limitations that will come into play as we get to the subsequent questions.

So, these are two questions that I'm going to ask together. So, I'm going to test your memory here. This question here is—the second question: A 403(b) plan didn't follow the terms of its document when allocating a 2008 contribution. Employees were excluded from receiving the contribution even though they were not excludable under the terms of the plan document. Can this be submitted to VCP for correction?

And before you answer that, there's also another question along similar lines. It says here a 403(b) plan has a discretionary contribution; they implore a declared contribution in prior years so that participants were expecting contributions, but the contributions were not made. Can this be submitted to VCP for correction so that employer can make the previously declared contributions for prior years? So, if you could take those two questions together?

S. Bennett: Both of these questions do go together because they both involve a violation of the plan terms. In other words, a plan sponsor had a plan but failed to operate the plan in accordance with its terms. Currently, such failure can not be submitted under the program because it's ineligible. Although the plan sponsor is not allowed currently to submit such errors for correction under VCP, the plan sponsor can go ahead and consult with its professionals and discuss correcting the errors in a manner similar to the correction methodologies that were outlined in the VCP program for similar failures. So, don't just wait. You may want to go ahead and consult with your professionals and take action based on some similar methodologies in the VCP program.

A. Bhagat: Okay, so basically, currently what we're trying to do is encourage correction; however, two things, a plan document problem as well as a failure to operate a plan in accordance with plan terms. Those are the two things that we can't address now. So, what we would like you to do is implement the correction, and then if you need to submit under the program when the program is opened up to address those failures. So currently, specific statutory violations of 403(b) can be addressed, but those that relate to plan document issues or the failure to follow the terms of that plan document, we're not able to address because of the limitations under the current revenue procedure. So then, moving along from that there's another question on the 403(b) issue. When will the 403(b) prototype program be finalized?

S. Bennett: At present, there's no update beyond the announcement 2009-34, and that announces the intent to establish the prototype program. But it is important to note that Announcement 2009-89 grants 403(b) plan sponsors the equivalent of a remedial amendment period, while the IRS works at developing a prototype or other form of preapproved 403(b) plan document. So, this means that plan sponsors will have some ability to retroactively correct form defects relating to the plan document requirements under section 403(b). Specifically, as long as a plan is in place on December 31, 2009, that is intended to satisfy the requirements of 403(b) and the regulations, the plan gets a period retroactive to January 1, 2010 to correct any form defects, as long as the sponsor adopts the preapproved plan or applies for an individual determination letter

when eligible. Of course, in the interim period, the plan must operate in accordance with the statutes and regulations to the extent applicable, but the plan does not have to include the specific provisions in its current plan document.

A. Bhagat: Okay basically, unlike 401(a) plans, you don't have any interim amendment deadlines or deadlines for amending ... statutes like the Pension Protection Act or that kind of thing at this time. The only deadline requirement that you have is the December 31, 2009 deadline for adopting a plan that is intended to comply with applicable 403(b) rules.

Okay, so shifting gears from 403(b) plans, we have a SEP question. If a sole proprietor with no employees makes an excess SEP contribution due to an overstated projection of net income for the year, how should that be corrected, and what are the tax penalty implications?

S. Bennett: Well, from the correction standpoint, the excess amount plus earnings through to the date of correction should be returned to the sole proprietor. In addition, the sole proprietor would need to reduce deductions taken on Schedule C for the SEP contribution to the applicable deductible limit. The deductible limit for SEP contributions is 25% of compensation. But it is important to note that when figuring the deduction for contribution made to a self-employed individual SEP/IRA, compensation is net earnings from self employment, which takes into account the following deductions. First, the deduction for one half of the individual self-employment tax, and second the deduction for contributions to the individual's own SEP/IRA.

A. Bhagat: Thanks for the answer. Also in addition to that, you may want to look into revenue procedure past Appendix F. We have different schedules. There's a schedule for numerous SEP/IRA issues. If you look at Schedule 3, there's a discussion there on how you correct for when you distribute excess employer contributions. So, I encourage you to take a look at that, and also Publication 560 has some good information on that.

So now, again changing gears entirely, we moved from the 403(b) world to the SEP world, and now we're getting into defined benefit plans. This deals with Code Section 436, and it's an adjusted funding target attainment percentage question AFTAP. And so, the question is as follows, a single employer defined benefit plan operating on a calendar year did not receive an AFTAP certification in 2010, but made lump-sum payments after September 30, 2010 and December 31, 2010. A late AFTAP certification is made, and the plan's AFTAP is certified to be above 100%. So, even though the AFTAP was late and the benefit payment should have been restricted, the distributions were made anyway. The lump-sum distributions were made anyway, but if the AFTAP was completed timely, no lump sums would have been restricted since the AFTAP was clearly above 100%. Can the plan sponsor rectify this under SCP, or does a VCP application need to be filed for this?

S. Bennett: Well, given that the 436 issues are new, we would suggest at this point that a VCP submission be filed. That would give the plan sponsor the comfort level of knowing whether a particular correction is acceptable to the service.

A. Bhagat: Okay.

S. Bennett: So VCP and not SCP.

A. Bhagat: Alright. Okay. So, moving along, the next question: When during the course of an employee benefit plan audit, original and signed employee benefit documents cannot be located, the plan sponsor's advised to enter into VCP or Audit CAP to resolve what is perhaps best characterized as a document failure. Is it official policy that a plan document must be signed and dated, and is the best real evidence of the intent of a plan sponsor to initiate an employee benefit arrangement? Is EPCRS the appropriate venue to replace missing signed and dated plan documents?

S. Bennett: Well, the employer is the one who makes the decision to come into VC, but if signed documents are missing, the employer might have difficulty substantiating whether the plan was timely amended for applicable legislation. There's not a signed document, where's the proof that this was done timely? There could be other basic questions too. For example, whether there was a definite written program or whether the plan provided for definitely determinable benefits. To address the problems posed by these questions, plan sponsors may use a program to correct these problems by having employer adopt plan documents that comply with the applicable laws, and then reflect how the plan was operated.

A. Bhagat: Okay, next question: A distribution provision in a defined benefit pension plan could be interpreted as allowing a participant to choose any annuity form of distribution the participant wishes. However, for at least the past ten years, during which time there were many distributions, the plan sponsor has narrowly interpreted the language, so that it does not allow a participant to select any annuity forms of distribution but rather that the participant can select only those annuity forms of distribution specifically offered. So in effect, the plan offered a specific set of annuity form options rather than the unlimited choice that the plan provided for. Could we just correct this by retroactively amending the plan through EPCRS to eliminate the any annuity form of distribution and reflect plan operation?

S. Bennett: Well, this question turns on the basic guidance in Section 4.05 of the revenue procedure regarding correction by plan amendment. That guidance provides the framework for correction by plan amendment, and it states that that form of correction is allowed when the amendment complies with the requirements of Code Section 401(a) including the requirements of Code Sections 401(a)(4), 410(b) and 411(d)(6). So, the correction can be accomplished, but you need to have that correction work within this framework. In this case, where the plan document states that the plan will offer participants any annuity form of distribution but it has operated such that participants' distribution options have been limited to certain annuity form corrections by plan amendment may be accomplished if there are no nondiscrimination or cutback issues.

A. Bhagat: So, if there is a cutback then the easy fix is gone. You can't just correct by plan amendment, and then you would have to fashion some sort of operational fix, which could entail offering participants additional forms of benefit payouts. And sometimes, correction is messy, so basically, if you're going to correct by plan amendment, make sure that the criteria is satisfied. Otherwise, an operational fix will be required, right? Okay.

The next question, and this one, too, kind of has a similar theme to it, I think. A 401(k) plan document has lump sum and installments as distribution options for terminated participants. However, in operation, participants were permitted to receive distributions in a lump sum, a partial lump sum and installments. So, for several years, terminated participants have been electing partial lump-sum distributions which are not explicitly allowed under the plan document. The number of effected participants is small, 49 out of 4,000. Can Self-Correction be used or should a VCP submission be filed?

S. Bennett: Okay, well based on the description of the failure, the failure appears to be an operational failure, in that the plan was not operated in accordance with its terms. Similar to the question before, if the goal is to allow the affected participants to retain the option of taking a partial lump-sum distribution, then the correction might involve amending a plan retroactively to permit partial lump-sum distribution. Self correction of an operational failure through a retroactive amendment is available only if the operational failure is one of the types of failures noted in Section 2.07 of Appendix B of the revenue procedure. Those failures relate to violations of the compensation dollar limit, the making of hardship distributions or loans without authorizing plan language and the inclusion of an ineligible employee. And since this failure outlined in this email question is not one of those types of failures, SCP would not be available to correct this failure.

A. Bhagat: Okay, so if choosing a plan amendment fix it would throw you out of the Self-Correction option. So, if you're going to choose a fix, it would have to be some kind of operational fix, and then after that, you would have to see whether the other self-correction requirements have been satisfied before you could use it. Otherwise, you would need to use the VCP options.

Alright, here's a SEP question again. An S Corp owner found after the 2000 year end that he had paid $3000.00 more than allowed under the 25% of salary limit into his SEP. In order to correct, a distribution back to the employer was made, prior to the due date of the tax return for 2010, for the excess contributions and related earnings. Is there a 1099-R to the employee reporting the distribution with no taxable amount? Then, on the employer side, are the earnings taxable in 2011, and will the employer be responsible for paying the 10% tax?

S. Bennett: Well, the answer to the first part can be found in Section 6.10(5) of the revenue procedure. The amount distributed to the plan sponsor is not includable in the gross income of the affected participant. The plan sponsor is not entitled to a deduction for such employer excess amounts, and the distribution is reported on Form 1099-R issued to the participant indicating the taxable amount as 0. So, that answers the first part of the question. As for the second part, there will not be a 10% tax consequence since this relates to excess amounts returned to the employer. The 10% tax under Section 72(t) relates to early distributions to the employee.

A. Bhagat: Okay, next question. Generally under EPCRS, when you do not let a participant into the plan when eligible and there is less than nine months left in the plan year, you correct using the ADP for the plan year in which the error occurred. If you find the error during the plan year, you would have to wait until the plan year is over and the test for that year is done. Is there a way to correct when the error is found immediately and not have to wait until testing is completed in order to avoid the possibility of additional earnings that would need to be calculated?

S. Bennett: We did get this question a couple times, and what can be done is that the plan sponsor can make an estimated correction during the year, and then once the ADP at the end of the year is determined, they can make the appropriate adjustments. For example, they can make additional contributions or remove any excess contributions made. As an alternative, you can always wait until the end of the year when the ADP is run.

A. Bhagat: So, the advantage of the estimate would be that if you can come up with and estimated ADP number, you can make a contribution now and that would stop the (clock). in terms of the earnings accruing on those corrective amounts. And then, you could make whatever adjustments you need to make at the year end. Right?

S. Bennett: Yes.

A. Bhagat: Okay the next question. In order to be eligible to use SCP, the plan sponsor must have in place practices and procedures designed to promote and facilitate overall compliance with applicable code requirements. The revenue procedure states that they can be informal, but do they need to be in writing, and is there any one thing that needs to be covered?

S. Bennett: Alright, well, the determination of whether the practices and procedures are sufficient depends on the plan's individual facts and circumstances. The revenue procedure does not provide specific guidance on what those practices and procedures should consist of. The guidance is broad. It does, however, provide that the practices and procedures should be designed to promote overall compliance with the applicable code requirements. Basically, that's the yardstick against which a plan's practices and procedures are going to be measured. So, that's the guidance.

It also provides that the plan document alone will not be sufficient for this purpose. And finally, the procedure should be established and routinely followed. For a failure to be eligible under SCP, it should have occurred on account of oversight or mistake in applying those procedures.

A. Bhagat: So, now moving on to let's look at VCP. When a failure is presented under VCP, or discovered under an audit, must the failure be fully corrected back to the year of the failure in which the failure originated?

S. Bennett: Well, when we were just talking about the slide, you mentioned the correction principles, and full correction is one of the correction principles in Section 6.02 of the revenue procedure. Under that principle, a failure is not corrected unless full correction is made for all participants and beneficiaries and for all taxable years involved. There are limited exceptions to the full correction requirement, and those are outlined in Section 6.02(5) of the revenue procedure. Among those exceptions to full correction are exception for small corrective distribution due to participants and beneficiaries and the recovery of small overpayments, as well as small excess amounts.

A. Bhagat: Okay so generally they have to meet one of the criteria in the exceptions ... in the revenue procedure, otherwise, the expectation is that full correction is required. Okay, so now, let's suppose the plan comes under examination. Are there any rules of thumb for determining how large sanctions in an Audit CAP can be?

S. Bennett: Well, there are no specific rules of thumb, but there is a general framework for negotiation. There is a maximum payment amount, which is the tax consequence arising from plan disqualification and the factors that are taken into consideration when negotiating the applicable sanctions. In addition to the general factors that are outlined in the revenue

procedure, it also provides that if one of the failures being corrected is a non-amender failure that the sanction amount will be higher than the fee that would have been assessed if the same issue was found during the course of the determination letter review. So, the fee for a non-amended failure found in determinations is significantly higher than the fee that would apply if the same failure was submitted under VCP. In general, it would be fair to conclude that one should expect significantly higher sanctions for the same failure under Audit CAP, than the fee that would apply if the same failure is corrected under VCP.

A. Bhagat: Alright. So, now moving on to specific corrections. When using the one-to-one correction method for an ADP/ACP failure, for purposes of allocating the corrected contribution, do we need to use compensation for the year of correction, or can we use the most recent year compensation we have? For example, the compliance statement for VCP is received during 2011, but the most recent compensation that the third party administrator has from the plan sponsor is for the 2010 year. So, which compensation do we use? Do I need to wait until the end of 2011 to make that determination? Do I use the most recent year? What year of compensation do I use in allocating the contribution piece of the one-to-one correction?

S. Bennett: Well interestingly, this question left out a significant fact is when did the failure occur because that's the compensation you would use. You would use the compensation for the year of the failure. While the plan sponsor is given some choice in who receives an allocation of the corrective contribution, one option is to provide an allocation to all non-highly comps in the year of the failure. Another option is to provide an allocation to all non-highly comps in the year of the failure who are also non-highly comps in the year of correction.

And there's another alternative or spin on both of these options. It is to provide the allocations to either of the group of employees in option one or two who are employees on a date during the year of correction that is no later than a date of correction, but the compensation used is the compensation for the year of the failure. And you can look at the example, example number one under Section 2.01 of the Revenue Procedure, Appendix B.

A. Bhagat: Okay. Can errors involving plan loans only be corrected in conjunction with VCP filing or can I self correct?

S. Bennett: Well, on this question if the goal is to obtain relief from tax consequences under Section 72(p), then VCP filing is the only option. But if the relief from the tax consequences under Section 72(p) is not being sought, then SCP may be available to correct loan failures.

A. Bhagat: So, if your goal is just to protect the qualification side of the plan, it's an operational problem where your loans did not comply with plan terms, and you're not worried about 72(p) relief, that is the participant will pay the tax, and maybe the employer would reimburse the employees for the tax consequence separately, so relief is not sought, then it could be possible that you might be able to use a self correction in order to fix the failure to comply with plan terms. However, anytime you want any kind of income tax or excise tax relief, and this includes relief from the tax consequence in the Section 72(p), then you would need the VCP submission for that purpose.

So, okay now, next question, that's a VCP question. We have heard that there are circumstances where a plan would not be required to retroactively amend a plan, document if a VCP submission states the plan is applying a provision retroactively. What criterion is used to determine if a plan needs to be retroactively amended or not? For example, a plan provides a match of 100% of deferrals up to 4% of compensation, but the document indicated the match was 100% of deferrals up to 3% of compensations. Does the plan and document need to be amended? Under what circumstances would the plan amendment be required?

S. Bennett: Well, in general if a plan is not being operated in accordance with plan terms, there would be two possible options for corrections. Either the plans operations would be adjusted to conform to plan terms. Basically, you're just going to have the plan adjust its operations to reflect what the plan specifically provided, or the plan would be amended to conform to the manner in which it was operated. For the amendment option to work, the requirements of Section 4.05 of the revenue procedure would need to be satisfied, and we discussed those couple questions ago. So, in the example laid out in this question, if the proposed correction was to allow participants to keep the match of 100% of deferrals up to 4% of compensations, instead of the 3% that was specified in the plan, the plan would have to be amended. So, it cannot be accomplished without a retroactive amendment.

A. Bhagat: Okay. Alright, this question deals with ADP/ACP testing. A plan uses permissive disaggregation for ADP/ACP testing and fails the test. However, refunds are not made within the 12-month deadline causing a plan failure. Can the plan use permissive disaggregation in determining the refunds to be made under SCP, or does Appendix B of the revenue procedure preclude the use of permissive disaggregation for determining both the refund amount and the QNEC allocation, and what about VCP?

S. Bennett: Okay. Well, in general disaggregation or restructuring into component plans is not permitted under the one-to-one correction method. So, if one wanted to do that under SCP, it is important to note that the correction method would not be a safe-harbor correction, and there would be no deemed reliance on that method of correction. So, under VCP, it can be submitted, and variations to the safe harbor might be considered on a case-by-case basis. So, it would have

to be submitted under—well, it wouldn't have to be submitted under VCP, but if it is submitted under VCP it would be analyzed and determined whether or not the proposed correction is sufficient.

A. Bhagat: So, but if you wanted a deemed reliance then disaggregation and restructuring would be out of—

S. Bennett: Yes.

A. Bhagat: If an employee is excluded from participating in a 401(k) plan, and there are no other employees in the excluded employees class, what ADP rate should be used to determine the missed deferral . opportunities. So, for example, you have an owner who hires an employee but does not allow that employee to participate in the plan, and there are no other non-highly compensated employees, and so now the owner wants to bring that employee in, what ADP use, there's no non-highly compensated employees and the employee in question is a non-highly compensated employee, so what's the framework for correction there?

S. Bennett: Well, in the example given in this question, there's not an employee in the excluded employee's class, so one possibility that can be used is to use the highly compensated employee's ADP as a proxy. So, use that because there is no relevant comparison for that employee's class.

A. Bhagat: Okay. Next question. We are preparing a VCP filing to be filed with the IRS in 2011 pertaining to an issue that may require refunds for a failed 2010 ACP test. If the VCP correction method is approved, we'll not need to make refunds at all. If the VCP correction method is not approved, we'll have to make refunds after we have received a response from the IRS. If the refunds are made in 2011 for a 2010 ADP/ACP test and if they're made timely in 2011, then only a 10% late refund penalty will be owed to the IRS. However, if we wait until the IRS responds to the VCP filing, which could well be sometime in 2012, then we would normally need to make also make a one-to-one QNEC because we'll need to correct using the one-to-one method. Does the filing of the VCP freeze the failed ACP test method of correction for refunds, and then do we have the ability of treating those refunds as if they were distributed in 2011? In other words, does the VCP filing in effect stop the clock? Can we treat the eventual correction as if it were made back in 2011?

S. Bennett: Well, this is a short answer, no. The filing of a VCP submission does not stop the clock on correction.

A. Bhagat: Gosh, after that long reading. Okay. Alright, and the next question. For 2009 and 2010, the plan required at least 1,000 hours of service to receive the matching contribution. In operation, though, the plan has given matching contributions to otherwise eligible, mostly non-highly compensated employee participants who are credited with less than 1,000 hours. Can the plan apply the Self-Correction method for early inclusion of an otherwise eligible employee to correct the failure?

S. Bennett: Well, yes. Assuming that the plan sponsor otherwise qualifies for SCP, but note that the plan sponsor who amends a plan to correct a failure using SCP must submit a determination letter application on the corrected amendment identifying the amendment separately in that determination letter application. The determination letter application must be submitted before the end of the plan's applicable remedial amendment period.

A. Bhagat: Which would be basically, so basically what the plan sponsor would do is adopt the amendment, and then when the time comes for its next scheduled determination letter application filing, which would be before the end of the applicable remedial amendment period, that particular amendment would be included in the filing, and it will be separately identified as such, as a corrective amendment.

If a plan timely adopted all required interim amendments but missed its EGTRRA filing cycle, can it be submitted to the VCP program, the missed cycle was A, so it's a cycle A plan, and the plan is now in the next round of filing.

S. Bennett: Yes, you can go ahead and submit. The plan sponsor can file an Appendix F Schedule 2 submission to indicate that the plan was not timely amended for its Cumulative List. In this example, it's the 2005 Cumulative List, and also note that a determination letter filing would need to be included with the submission.

A. Bhagat: Okay. And if you submitted the determination letter application separately already, then the best thing to do would be to notify us that the filing has been made, so we can coordinate that with the determination letter reviewer. And similarly, you would probably want to notify determinations that you have a VCP application pending. Alright, so that the two sides can coordinate with each other. So, the amendment procedure requires the two to be submitted together, but if you fall in that situation, when things are submitted separately, notify both sides.

The next question. A company regularly deposits employee deferrals on the day following the pay date. However, in one case out of 52, they deposited the employee deferrals 14 days after the pay date. At a minimum, we should inquire as to why the deposit was late and make an assessment as to whether it was ... feasible to have it made earlier. If not, it should be reported as a late remittance? So, it appears to be that an editorial comment here, and also I think there are things to be an overlap between two separate programs.

S. Bennett: Right. If it's determined that the deposits were late, there's a program offered by the Department of Labor. It's called the Voluntary Fiduciary Correction Program or the VFCP, and it gives plan sponsors and service providers the chance to correct specific transactions that violate ERISA, and one of them is delinquent participant contributions. There's no fee under the VFCP, but the VFCP does require payment of the appropriate correction amount to the plan.

However, if the plan had language relating to the timing of the contribution being deposited, there may be a qualification failure. So, you may be looking at VCP as well for failing to follow the terms of the plan. The correction would be to make the contributions with earnings up to the date of correction. Earnings should be based on the actual earnings of the participant's account whenever possible, and if it does fit within the parameters of VFCP, that can be used as well as VCP to correct this failure.

A. Bhagat: Okay. So basically, the primary problem is definitely a VFCP type problem as opposed to an EPCRS issue, but it could be an EPCRS issue if the timing is also tied to the terms of the plan document. Right?

S. Bennett: Right.

A. Bhagat: Okay. Next question. Our client has identified a number of loans that are delinquent and need to be re-amortized. In this case, scheduled payments have been made, and the loan is not tracking to be paid off within its original term. This is due to payments not being started on a timely basis because of issues with the payroll system. Could the employer have the options to leave the payments unchanged and then make a one-time payment at the end?

S. Bennett: So, in this example where payments were missed, you can't do a balloon payment at the end. It's not allowed, but what could have happened is a large payment could be frontloaded, but you can't backload a balloon payment.

A. Bhagat: So, the most participant-friendly option would be to re-amortize and you just have a higher payment for the remaining period of the loan. But yes, you cannot just keep the same amortization schedule and make a larger balloon payment at the end.

Okay, next question is also a loan question. A participant has issued a plan loan in excess of the applicable code section 72(p)(2)(A) amount, which is the section that talks about loan limits. The excess loan was corrected under VCP, and the compliance statement was issued. The participant now wishes to request another plan loan and wants to know what would be available under his account. Can that amount be figured as if the excess loan amount had never been issued, or does the excess amount need to be factored in post correction when determining how much the participant could take for his new loan?

S. Bennett: Well, in this case, since the excess amount was corrected, the amount available for the loan is determined using the corrected loan amount, so disregarding that excess amount on the loan which was corrected under VCP.

A. Bhagat: So based on the correction, and once the correction is done, then the loan is treated as if the loan within the applicable 72(p)(2) limit was taken at that point and time. And that would be the amount you would use as your reference for figuring out how much a participant could take at a future point and time.

Okay, so that's it for the questions piece, and we don't have a whole lot of time, so what I will do is I'll get back to the slides, and what I want to do is there are a couple of things. Let's look at slide 19. It deals with the VCP submissions common errors. And these are things that we've come up with that are pretty much mechanical errors that if you took care of it, would make the processing of applications a lot easier and would speed up the process considerably. So, what I want to do is kind of cover some of these items briefly.

The first one is that sometimes you get the application, but the fees are not submitted along with them. And now, given the volume of applications that are coming in, very often these applications will just be returned, rather than subsequent requests saying okay, where's the check and can you submit the check at that point. So, it's pretty critical that the applicable fees are submitted along with the application, and if you're submitting a VCP application along with a determination letter application, two separate fees apply, and make two separate checks; one for the VCP and one for the determination letter application.

The failure to submit with correct signatures. For example, a common one is the Penalty of Perjury Statement must be signed by the plan sponsor. The Power of Attorney cannot sign the Penalty of Perjury Statement. So, that's a pretty common error.

Just incomplete submissions. All required items are not submitted. Incomplete or inaccurate Power of Attorney forms, and sometimes actually, you might even have a cover letter that outlines an entire list of items submitted which indicates that you have considered all the items required, but then when you're looking at the underlying documentation, a lot of the items mentioned in that list are not included. So, this is something that you could very easily just take care of on the front end before making that submission that would prevent a lot of back and forth that follows.

S. Bennett: And a common one with that point is the failure to include the prior plan document with Appendix F Schedule 2 filings. That's a failure that we commonly see.

A. Bhagat: Great. Okay. Sometimes we get kind of hypothetical submissions where the failure is not presented as a failure and the applicant is asking the IRS to determine if a failure occurred. Basically, that's a determination you need to make before you make the submission, so when it's presented to us, it's presented to us as a failure. Now, what you can do is basically say that the failure is a failure for purposes of the submission alone, and that's perfectly fine. So if you want

that kind of coverage where you think that you don't want to admit that it's a failure for other purposes, the revenue procedure does provide you with an out of saying that you're admitting that this is a failure for purposes of this submission, but you need to identify that as a failure. We're not making determinations that to whether a failure occurred or not. For that, you have other great programs, such as the Private Letter Ruling Process, that that might be of more assistance in that process.

Scrivener's Error, okay now. Scrivener's Error's is a concept we don't recognize in VCP submissions. Now you could get to a similar place because basically what you would be coming in for is that your plan was operating in a manner that was inconsistent with plan terms, and there the announcement if you're proposing that the fix should be a plan amendment to reflect the manner in which it was operated. That's how you would come in. You wouldn't present it as a Scrivener's Error because if it's considered a Scrivener's Error, that doesn't fit within EPCRS, and so that's a lot of times we'd be forced to ask you to refine your submission in order for us to be able to address it. Otherwise, we're not in a position to address your submission.

There's also, if you look at the slide, there's also an article on common mistakes in VCP submissions. We encourage you to take a look at that. And finally, please review the application packets before sending it in. We kind of talked about that earlier. Sometimes, your cover letter might indicate that you submitted all these items, but they're not actually there in the underlying package, things like the fees and those kinds of things. These are mechanical mistakes that (with) just a quick review of the package, you should be able to catch that.

So anyway, these are kinds of things that we thought worth mentioning because we are really trying to accelerate the pace in which we process applications. We're really, really encouraged and grateful for the fact that you are using the program. Our number of receipts has almost doubled, and that's a really good thing. That means that you're really proactive in terms of pursuing corrections. And we would like to work with you in getting you the responses that you need as soon as you can, so that you can go on with a regular business of operating the plan well. And so, we just thought as a friendly reminder that we would mention these kind of mechanical avoidable mistakes so that it would help us do our job and help you get the responses you need expeditiously.

Okay, so with that, I think we're close to the end of our time, so I guess the last thing I would mention is look at in the slides from slide 29 onward, there's a discussion on certain selected correction issues, issues relating to compensation, exclusion of eligible employees and the impact of automatic enrollment, whether you can use corrective QNECs for failed ADP/ACP tests, the failure to provide notices and Safe Harbor 401(k) plans, hardship distribution issues, loan issues, so those are the kinds of things that I think you'll find interesting in the Power Point presentation. So with that, I'd like to—Stephanie and I both would like to thank you for your participation in the program.

S. Bennett: Thank you.

A. Bhagat: Thanks.

Moderator: And that does conclude our conference for today. Thank you for your participation and for using AT&T Teleconference services. You may now disconnect.