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## **SPECIAL BULLETIN – May 8, 2006**

### **IRS Issues New Revenue Procedure for the Employee Plans Compliance Resolution System**

Late on May 5, 2006 the Internal Revenue Service issued Revenue Procedure 2006-27, IRB 2006-22, which revises the Employee Plans Compliance Resolution System (EPCRS). The long awaited new procedure is more user friendly and contains expanded eligibility. EPCRS is expanded to include additional types of failures that are available for correction under the program and also details new allowable correction methods.

The improvements in EPCRS include:

- ❖ A new correction method for employees that were not notified timely of their eligibility to participate in a 401(k) or 401(m) plan
  - QNECs can be made at 50% of the missed deferral for pre-tax contributions;
  - QNECs can be made at 40% of the missed after-tax employee contribution;
  - No correction required for missed employee contributions (both deferral and after-tax) if the employee was notified before the last 9 months of the plan year;
  - QNECs for matching contributions are made based on the matching formula for the plan (also required for insubstantial missed employee contributions even though plan sponsor is not required to make QNECs for missed employee contributions)
- ❖ New correction methods for participant loan failures
  - Limit on maximum loan amount is exceeded
    - Participant repays the excess amount; and
    - Remaining loan balance reamortized over the remaining life of the original loan; and
    - Prior loan payments attributable to the excess can be applied to interest on excess so participant only repays the excess amount or can be applied to the remaining loan balance and the participant repays the excess plus interest.
  - Maximum loan period is exceeded
    - Loan is reamortized over the remaining period that will meet the 5 year limit unless the loan was for principal residence.



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- Where plan loans were defaulted and not reported, but the repayment period has not expired
  - Option 1 – participant makes a lump sum payment to bring the loan current (including interest) and continues payments based on original amortization schedule
  - Option 2 – loan is reamortized over the remaining life of the original loan.
  - Option 3 – any combination of Options 1 and 2.
  - Employer may be required to pay a portion of the correction payment if the employer was partially at fault in not starting loan repayments timely.
- ❖ Rules regarding eligibility for EPCRS when the plan or plan sponsor has been involved in an EP tax shelter transaction
  - New disclosure requirement regarding the plan's or plan sponsor's participation in a tax shelter transaction that is listed on the IRS website under "EP Abusive Tax Transactions."
  - Participation by the plan/plan sponsor in an EP tax shelter transaction can eliminate the availability of programs under EPCRS
    - SCP not available if operational failure is directly related to an EP tax shelter transaction.
    - VCP
      - ⇒ Plan/plan sponsor was or may have been a party to an EP tax shelter transaction – referred to EP Tax Shelter Coordinator.
      - ⇒ Failures in application related to an EP tax shelter transaction – case referred to EP Exam
      - ⇒ Failures in application are unrelated – compliance statement can be issued.
    - Audit CAP and SCP (while under Examination)
      - ⇒ Plan/plan sponsor was or may have been a party to an EP tax shelter transaction – referred to EP Tax Shelter Coordinator.
      - ⇒ Failures relate to an EP tax shelter transaction – IRS reserves right to conclude that neither program is available.
      - ⇒ Satisfactory corrective actions have been taken – IRS reserves the right to conclude that neither program is available.
- ❖ Expansion of the program to terminating orphan plans including more flexibility for the correction of qualification failures and the payment of fees under the VCP and the Audit Closing Agreement Program (Audit CAP);



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- ❖ Failure to Obtain Spousal Consent to Distributions
  - Old method still available. If spousal consent cannot be obtained, spouse is entitled to a benefit that is equal to the portion of the QJSA that would have been payable to spouse under the plan at the annuity starting date (ASD).
  - Alternative method. New method permits correction by a lump sum payment to the spouse equal to the present value of the annuity determined under the old correction method.
    - Interest and mortality factors in Code section 417(e)(3) must be used to calculate lump sum.
- ❖ New streamlined procedures under VCP for failures to amend a plan for good faith and interim amendment requirements.
  - Determination letter application not required unless the amendment is adopted to correct
    - A non-amender failure; or
    - The amendment is adopted to correct failures in the plan's cycle year/year of termination.
- ❖ Excise tax changes
  - Relief from the excise taxes for nondeductible contributions where the plan sponsor is required to make a contribution as part of the correction.
  - Relief from excise taxes relating to non-timely distribution of excess contributions or excess aggregate contributions where testing was timely and inaccurate data resulted in underpayment.
  - Submission must request relief from these excise taxes.
- ❖ Changes related to fees.
  - Reduced fee of \$500 where the number of affected participants is 50 or less who did not receive required minimum distributions timely.
  - Fees for orphan plans may be waived by the IRS in its discretion..
  - New fee schedule that will apply to nonamender issues discovered during the determination letter process. Fee will be based on
    - Number of plan participants and
    - The law change for which the plan was not amended.
  - Reduced fees (VCP is \$250) for SEPs and SIMPLE IRA plans.
- ❖ New procedural enhancements.
  - Sample acknowledgement letter has been added as Appendix E.
  - Applicants need to submit Acknowledgement Letter with the application if they wish to receive an acknowledgement from the IRS.
  - New section that deals with assembling the submission has been added to expedite processing.



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- Notice to the participant that an excess amount is not eligible for rollover is not required where the excess amount is not the result of a statutory limit.

### ***Effective Date***

The new EPCRS procedures are generally effective September 1, 2006. However, plan sponsors are permitted to use the new procedures at their option on or after May 30, 2006.