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EMPLOYEE BENEFITS AND EXECUTIVE COMPENSATION

IRS OPENS NEW OPTIONS FOR SELF-CORRECTING RETIREMENT PLANS

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The IRS has a system of correction programs for sponsors of retirement plans, the Employee Plans Compliance Resolution System (EPCRS). Recently released IRS Revenue Procedure 2019-19 (Rev. Proc. 2019-19) allows for more issues to be fixed by self-correction. Practitioners in employee benefits requested expansion of EPCRS and the IRS listened. Employers needing to correct an operational or document problem will benefit in certain circumstances.

By correcting plan issues, an employer can preserve the qualified status of its plan and avoid costly sanctions. The IRS encourages timely and efficient mending of failures through self-correction of routine issues, voluntary submission of more complex matters to the IRS, or a last-resort correction on audit. The self-correction method does not require a fee and is quickest, when it is available.

Plan Loans to Participants

Retirement plan documents can be written to allow participants to take a loan from the plan and pledge their account balance as collateral. In general, these loans must be repaid over a five-year period. Plans are often set up so that the repayment happens through payroll deduction. When a participant defaults on loan payments, the plan will give them a short period of time to catch up on payments and remedy the default. If they fail to bring the loan current, the rules require the plan to report their failure as a taxable "deemed distribution" or as an offset of the account balance if there is an actual distribution. The outstanding balance of the loan, at the time of a deemed distribution, is reported as taxable income to the participant.

One thing to keep in mind when setting up and administering participant loans under a plan, is that the IRS has taken the position that a five-year term means five years from the date of the loan, not five years from the date of the first installment payment, which is how many recordkeepers set up loans. An employer can simplify plan administration and avoid exceeding the permitted loan term by paying attention to the total number of payments to be scheduled. For example, a five-year loan could be amortized over 59 months rather than 60 months. This will give time for your payroll administrator to set up the deduction and also better assure that the loan is repaid within five years from origination.

If a loan defaulted and a deemed distribution was not timely reported, the general tax rules have provided for reporting the taxable income for the year of the failure; the participant may need to file an amended tax return. Another option has been to file an application under the voluntary correction program (VCP), including the applicable user fee, to either reamortize the loan or report it as taxable income for the year of correction. With Rev. Proc. 2019-19, the IRS expands the rule to allow reporting of a deemed distribution in

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the year of the correction or reamortizing of the participant loan as a self-correction, without a formal application to the IRS and without a user fee. If the loan is reamortized under self-correction, the IRS guidance states that the employer will need to pay accrued interest on missed payments. Further, if the recordkeeper amortized a five-year loan from the date of the first payment rather than the date of origination, there may be some uncertainty whether correction of a defaulted loan can be completed under the Self-Correction Program (SCP) since that correction under SCP is available only if the loan otherwise satisfies the Code requirements, including the maximum five-year term. With VCP, the issuance of a compliance statement would provide assurance of an acceptable correction. It may be necessary to consider whether reamortization through self-correction is the desired approach for a particular situation.

Plan Document Failure

There are times when a plan document might not meet the requirements of the Internal Revenue Code. With preapproved plans, this would happen infrequently, such as when conflicting plan provisions have been selected or the document provider fails to adopt interim amendments. It's much more likely that an employer did not amend its plan document during an applicable remedial amendment period. Under the old rules, the only way to correct this failure was through VCP or audit CAP. This could be a costly and lengthy process to bring the plan into full compliance.

Rev. Proc. 2019-19 provides for self-correction of plan document failures for qualified plans and 403(b) plans. In the right circumstances, this could save an employer time and money. There are limits on when self-correction applies. There must be an existing plan; self-correction cannot be used to start a new plan. The correction generally must be made by the end of the second year when the plan amendment was required. A qualified plan that is individually designed must have a favorable determination letter, or the plan must be a preapproved plan. And self-correction cannot be used for document failures of a SEP or SIMPLE IRA document. This change in the EPCRS can be useful when document failures are identified soon after they are needed. The importance of a periodic review of plan documents becomes clear.

Plans that do not meet each of the requirements for self-correction can still use a VCP application to come back into compliance.

Keep in mind that at times when plan amendments are needed, it is often the best time to consider whether the plan design still meets the employer's objectives. HSE can work with you to integrate both regulatory and strategic updates of your plan.

Plan Amendments to Correct Operational Failures

A retirement plan must, of course, be operated according to the terms of the plan. When that doesn't happen, a correction is needed. Rev. Proc. 2019-19 expands the options for correction by allowing a plan amendment to conform the terms of the plan to the way it has actually been operated in certain instances. One can guess that there are requirements to be satisfied. For SCP, the amendment must result in an increase of a benefit, right, or feature of the plan. The increase must apply to all plan participants. And the increase must be permissible under the Internal Revenue Code and satisfy the IRS correction principles. An example of the type of operational failure that can be self-corrected by amending your plan might be a plan

that distributed a participant hardship withdrawal which plan provisions did not allow. The employer could amend the plan to retroactively allow hardship withdrawals by all participants, under the IRS rules.

While an amendment permitted under SCP can be done quickly, it will have lasting effects and may increase the cost of funding a plan going forward. A VCP may still be appropriate if an alternative correction will be proposed, and a VCP offers an increased level of certainty for your plan. We can assist to determine the best possible option for your particular circumstances.

If you need additional assistance, please contact any member of our Employee Benefits and Executive Compensation Group at 585.232.6500, 716.853.1616, or visit www.hselaw.com.

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