Employee Benefit Plan Voluntary Correction Programs: Fixing Costly Errors and Preserving Tax Benefits

WEDNESDAY, MARCH 1, 2017, 1:00-2:50 pm Eastern

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Employee Benefit Plan Voluntary Correction Programs

March 1, 2017

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Today's Agenda

- Introduction and significant initiatives
- Who is a fiduciary?
- Basic fiduciary responsibilities
- Difference between fiduciary and operational violations
- Overview of Agency Voluntary Correction Programs
  - Department of Labor
  - Internal Revenue Service
- Common Compliance Errors
- Best Practices

Significant Initiatives by IRS

- IRS uses “multi-tiered” plan audit strategies
  - EP Compliance Unit (EPCU)
  - Large Case – Employee Plans Team Audit (EPTA)
  - Compliance Programs/Initiatives
- Push for proactive identification of errors and correction

Helpful IRS Resources

- Common Plan Errors and How to Correct Them:
  - http://www.irs.gov/Retirement-Plans/Plan-Sponsor/Fixing-Common-Plan-Mistakes
  - http://www.irs.gov/Retirement-Plans/Correcting-Plan-Errors
  - IRS “Fix It Guides”: https://www.irs.gov/retirement-plans/plan-sponsor/fix-it-guides-common-problems-real-solutions
- Recurring Plan Mistakes Often Identified on Audit with Related Tips: http://www.irs.gov/Retirement-Plans/EP-Compliance-Trends-and-Tips

Significant Initiatives by DOL

DOL/EBSA Activity By Fiscal Year

Activity	2016	2015	2014	2013
Civil Investigations	2,002	2,441	3,928	3,677
Criminal Investigations	333	275	365	320
VFCP Filings Received	1,490	See below	1,643	1,535
DFVCP Filings Received	22,070	24,335*	25,060	23,031

*Total VFCP and DFVCP applications for FY 2015

Significant Initiatives by DOL (cont'd)

- $777.5 million in recoveries for FY 2016 (compared to $696.3 million for FY 2015)
  - 2016 number includes $9.5 million collected through VFCP and $352 million through enforcement actions
- More information on 2016 FY statistics available at: https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/ebsa-monetary-results.pdf

Who is an ERISA Fiduciary?

- Anyone who has or exercises discretionary authority, control or responsibility over the management, investment or administration of an ERISA plan
- Includes:
  - Plan administrator (e.g., members of retirement plan committee)
  - Company staff members, to the extent they make initial decisions regarding eligibility to participate in the plan, claims or other discretionary determinations
- Excludes:
  - Day to day, nondiscretionary ministerial duties carried out by employer personnel
- Consider whether a potential fiduciary duty involves strict application of plan terms

Basic ERISA Fiduciary Duties

- ERISA Section 404 Rules:
  - Exclusive Purpose (Duty of Loyalty)
  - Prudence
  - Diversification
  - Plan Document

- ERISA plans must also:
  - Be reflected in a written plan document containing minimum terms
  - Obtain appropriate bonding coverage
  - Reflect an ERISA-compliant claims review procedure
  - Avoid entering into prohibited transactions

Difference Between Fiduciary and Operational Violations

- Examples of fiduciary violations:
  - Failure to act prudently in selecting plan investments or third party service providers
  - Failing to ensure that only reasonable administrative expenses are paid by a plan
  - Engaging in self-dealing transactions
- Examples of operational violations:
  - Failure to implement 401(k) plan automatic enrollment provisions for a group of new employees
  - Making plan distributions for an event that is not provided for in the plan (e.g., in-service distributions)

Overview of Correction Programs

- Voluntary compliance encouraged by DOL and IRS
  - VFCP (Voluntary Fiduciary Correction Program)
  - DFVC (Delinquent Filer Voluntary Compliance)
  - EPCRS (Employee Plans Compliance Resolution System)

- Early detection of operational errors reduces cost AND fiduciary liability

DOL Correction Programs

- VFCP and DFVCP
- Apply if the DOL has not already reached out to the plan or plan sponsor about the deficiency
- Penalties cannot be paid using plan assets

DOL Correction Programs: VFCP

- Covers 19 specific fiduciary transactions, including:
  - Delinquent Participant Contributions
  - Improper Loans
  - Improper Plan Expenses
  - See https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/faq-vfcp.pdf
- Restore the plan (and its participants) to the position it would have been in had the transaction not occurred
  - May require valuations for assets other than exchange traded securities

DOL Correction Programs: VFCP (cont'd)

- Model application form and online correction calculator available on DOL website
- Cross-over with IRS enforced excise taxes for certain transactions
- No “self-correction” without DOL filing

DOL Correction Programs: DFVCP

- Encourages voluntary compliance with Form 5500 annual reporting requirement
  - See https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/faq-dfvc.pdf
- Without DFVCP, penalty for failure to file Form 5500 would be up to $2,063/day
- DFVCP fees:
  - $10/day, up to the per-filing cap of $2,000 for plans with at least 100 participants (“large plans”) and $750 for “small plans” with less than 100 participants
  - Per plan cap of $4,000 for large plans or $1,500 for small plans
    - Ex: Large Plan A fails to file in three or more separate years

DOL Correction Programs: DFVCP (cont'd)

- No "per sponsor" or "per administrator" cap
  - Ex: XYZ Co. sponsors three large plans that each failed to file Form 5500s in four separate years
    - DFVCP fee amount: $4,000 x 3 = $12,000
- Penalty calculator available on DOL website
- Payment made online through DOL website

IRS Correction Program

Internal Revenue Service

- Three types of corrections available under IRS Employee Plans Compliance Resolution System (EPCRS)
  - SCP (Self Correction Program)
  - VCP (Voluntary Correction Program)
  - Audit CAP
- Addressed in IRS Revenue Procedure 2016-51 (effective January 1, 2017)
- See https://www.irs.gov/retirement-plans/epcrs-overview

IRS Correction Program: SCP

- No IRS fees
- No IRS filing
- Applies to “operational” failures only
- Applies to insignificant and certain significant failures
- Should follow general EPCRS correction principles and maintain records to demonstrate correction made
- Change administrative practices so error does not recur in the future

IRS Correction Program: VCP

- Pay limited fee to IRS
- Notify IRS via filing submission
  - Form 8950 (Application for VCP)
  - Form 8951 (Compliance Fee for VCP)
  - Form 14568 (Model VCP Compliance Statement)
  - Special Schedules for “streamlined” correction of certain errors
- Requires IRS approval
  - Correction must be completed within 150 days
- Applies to all types of “qualification failures”

IRS Correction Program: VCP (cont'd)

- Failures Eligible for VCP Streamlined Submissions
  - Nonamender (Interim and Certain Discretionary Amendments and Failure to Adopt a 403(b) Plan Timely)
    - Ex: Failure to adopt timely amendments for HEART Act or PPA
  - Plan Loan Failures by a Qualified or 403(b) Plan
    - Ex: 401(k) plan loan exceeds the limits on amount or duration under Code section 72(p)
  - Employer Eligibility Failures by a 401(k) or 403(b) Plan
    - Ex: 401(k) plan adopted by an ineligible (governmental) employer
  - Missed Corrective Distributions for Elective Deferrals Exceeding the Code section 402(g) Limit ($18,000 for 2017)

IRS Correction Program: VCP (cont'd)

- VCP Streamlined Submissions (continued)
  - Failure to Comply with Required Minimum Distribution Rules
  - Correction of Certain Operational Failures by Plan Amendment
    - 401(a)(17) Compensation Limit ($270,000 in 2017)
    - Hardship Distributions or Plan Loans Not Provided for in the Plan
    - Early Inclusion of Otherwise Eligible Employee
  - Certain Failures made by SEPs, SARSEPs, and SIMPLE IRAs

EPCRS Correction Principles

- Full correction required
- Follow plan terms at the time of the failure (unless the correction involves a plan amendment)
- Restore benefits to plan/participants
- Reasonable and appropriate correction
    - Keep plan assets in the plan unless otherwise required by law
- Correction methods should be applied consistently for all operational failures of the same type during a plan year

EPCRS Eligibility Chart

	SCP Insignificant	SCP Significant	VCP	Audit CAP
Qualified Failures	Operational	Operational	All	All
Egregious Errors	No	No	Yes*	Yes
Plan Exclusions	None	IRAs	None	None
Favorable Letter Required	No	Yes**	No	No
Established Procedures Required	Yes	Yes	No	No
Under Examination	Yes	No	No	Yes

*The IRS may impose a sanction that is larger than the prescribed VCP user fee
**A determination letter on an individually designed plan need not be current to meet this requirement (due to recent changes in the determination letter program).

VCP Fees

Number of Participants	Fee*
20 or fewer	$ 500
21 to 50	750
51 to 100	1,500
101 to 1,000	5,000
1,001 to 10,000	10,000
Over 10,000	15,000

Source: https://www.irs.gov/retirement-plans/voluntary-correction-program-fees

*****Limited exceptions may apply; fees updated annually by the IRS as deemed necessary

IRS Correction Program: Audit CAP

- "Closing Agreement Program"
  - Plan failures uncovered upon IRS plan audit
  - VCP not available
  - SCP available for "insignificant" operational failures and "significant" operational failures that are "substantially completed" prior to audit
- Correction Procedures
  - Apply correction principles that make participants "whole"
  - Plan sponsor and IRS agree on correction method – "correction agreement" signed by plan sponsor and IRS

Audit CAP Sanction Fees

- Previously determined as a negotiated percentage of the "Maximum Payment Amount"
- Now determined based on the relevant facts and circumstances, including multiple factors listed in the EPCRS procedures (e.g., steps taken by plan sponsor to avoid plan failures and to identify and correct failures)
  - Maximum Payment Amount is one factor that may be considered
- Sanction generally cannot be less than the applicable VCP user fee
- Special rules for determining fees in certain cases:
  - Plan loan errors caused by the plan sponsor
  - Transferred assets
  - Nonamender failures discovered by the IRS while reviewing a determination letter application

Audit CAP Sanction Fees (cont'd)

- Example:
  - IRS discovers a nonamender failure (with no other failures) while reviewing a determination letter application filed by an individually designed or pre-approved plan:
    - For more recent nonamender failures, the fee would be 150% of the VCP user fee that would otherwise apply
    - For older failures, the fee would be 250% of the VCP user fee
  - Assesses a “premium” on the IRS’ discovery of the failure
  - The prescribed sanction may also be reduced or increased based on the facts and circumstances, such as whether the failures were egregious

Common compliance pitfalls what really could go wrong?

1. Participant Data & Eligibility

1a. Eligible participants not included (auto enrollment errors)

1b. Ineligible participants included

2. Payroll & Contributions

- 2a. Incorrect definition of compensation
- 2b. Untimely remittance

3. Benefit Payments

- 3a. Incorrect vesting applied
- 3b. Hardship distributions incorrectly administered

4. Loans

- 4a. Loan payments not deducted
- 4b. Defaulted loans

Participant Data & Eligibility Case Study 1a. – Errors in administering auto enrollment

Scenario

- Plan provides for automatic enrollment of participants. During December 2016 (employer's busy time), a handful of participants were hired, but they were not automatically enrolled in the plan on January 1, 2017, as required by the plan.

Issues

- Failure to automatically enroll is an operational failure.
- Results in missed contributions to the plan.

Resolution

- Employer makes contribution equal to 50% of the amounts that would have been contributed under automatic enrollment plus lost earnings and employer match on missed contributions*.
- Plan may provide for a 90-day election for employees to opt out of automatic enrollment. Under this election, any remitted contributions will be refunded to the employee.

**See, e.g., Rev. Proc. 2013-12, App. A, § .05*

Best Practice

- If initiating auto enrollment for the first time run a census report from payroll a week or so before auto enrollment is set to begin and identify those who will be affected. On payroll day cross check this list with deductions to ensure you either have a zero election form or that they have deductions.
- For ongoing auto enrollment institute procedures in HR/Payroll whereby all new hires eligible for auto enrollment are flagged for review in the payroll report.
- Have payroll service provider set up custom reports to identify those who would become eligible for auto enrollment each pay period.

Participant Data & Eligibility Case Study 1b. – Ineligible employee included in the plan

Scenario

- 401(k) plan allows only employees who have completed three months of service to participate in the plan. In October, an employee is hired and allowed to begin participating in the plan immediately.

Issue

- Allowing ineligible employees to participate early is operational failure.
- Results in excess contributions to the plan.

Resolution

- Refund impermissible contributions including earnings or losses.
- Any employer contribution that may have been applied to this person's account will be forfeited into the plan and used according to plan document's guidelines for forfeiture usage.
- Amend plan to allow participation of these types of ineligible employees, but only if requirements of Rev. Proc. 2013-12, App. B, § 2.07 are met.

Best Practice

- Educate payroll/HR on plan provisions.
- Identify and create reports that show new hires along with their employee class and eligibility status. Review periodically for non-compliance.

Payroll & Contributions Case Study 2a – Incorrect definition of compensation

Scenario

- Plan defines compensation as W-2 compensation, adjusted for deferrals into the 401(k) plan and cafeteria plan. Certain participants had noncash fringe benefits during the year that were added to their W-2, but not included on any payroll.

Issues

- Improper compensation used to calculate deferrals, employer match, and profit-sharing contributions.

Resolution

- Verify that eligible compensation is calculated using the plan document definition.
- Noncash fringe benefits should be included in the final payroll for the year, instead of as a W-2 adjustment.
- Verify proper coding of all payroll-related items.
- Take corrective action.

Best Practice

- Educate payroll/HR on plan provisions.
- Any new additions to payroll codes should be reviewed by a supervisor and should be cross checked with plan guidelines to ensure it is properly flagged for 401k purposes.

Payroll & Contributions Case Study 2b – Untimely remittance

Scenario

- Employer sponsors 401(k) plan. Employer deposits employee contributions into trust for 401(k) plan at various lengths of time following pay date.

Pay Date	Date Deposited in Plan	No. of Business Days
2/15/2017	2/24/2017	6
3/15/2017	3/29/2017	10
6/14/2017	6/21/2017	5
7/12/2017	8/28/2017	33
9/27/2017	10/10/2017	8

Payroll & Contributions Case Study 2b – Untimely remittance *(cont'd)*

Issues

- DOL requires that participant contributions be deposited into trust "as of the earliest date on which such contributions can reasonably be segregated from employer's general assets." 29 C.F.R. § 2510.3-102.
- In no instance, later than the 15th day of the following month.
- Seven business day safe harbor for small plans.
- Late remittance is considered to be a loan from the plan to the plan sponsor, which is a prohibited transaction.

Payroll & Contributions Case Study 2b – Untimely remittance *(cont'd)*

Resolution

- Calculate lost earnings and restore to participants.
- Consider filing application under Voluntary Fiduciary Correction Program and/or filing Form 5330.
- Check box for "yes" on Schedule H of Form 5500, Part IV, line 4a.
- Plan financial statements should include a footnote describing the prohibited transaction.
- ERISA requires a supplemental schedule for prohibited transactions. The DOL has a prescribed format.

Best Practice

- Educate payroll/HR on DOL requirements on timely contributions.
- Create a policy for contribution remittance and stick to it.
- Maintain reports showing date of payroll, amount of contributions and date funded and review for completeness and timeliness.

Benefit Payments Case Study 3a – Incorrect vesting applied

Scenario

- Employer laid off 25 employees in 2015. The Plan had 120 participants on January 1, 2015 and 90 participants as of December 31, 2015. The Plan uses three- year cliff vesting.

Issue

- A partial plan termination requiring 100% vesting may have occurred (see Rev. Rul. 2007-43).

Resolution

- Consult ERISA attorney on whether partial plan termination occurred.
- If so, all affected participants are considered to be 100% vested.
- Forfeitures should be returned to the participants to properly correct vesting.

Best Practice

- When company is going through large layoffs be sure to discuss these provisions with management.
- Keep good records of previous employee accounts whereby if at a later stage you need to go back and pay out employees you can do so without incurring additional charges from TPA/Service provider.

Benefit Payments Case Study 3b – Hardship distributions incorrectly administered

Scenario

- Plan allows participants to take a hardship distribution when necessary to prevent the eviction of the employee from the employee’s principal residence or foreclose on the mortgage on that residence. Employer allowed five employees to receive distributions to prevent foreclosure. Only documentation in plan records is an application on which participant notes he is facing foreclosure.

Benefit Payments Case Study 3b – Hardship distributions incorrectly administered

Issues

- Lack of documentation that distribution was due to financial hardship.
- Required procedures for occurrence of hardship distributions.

Resolution

- Plan should request documentation from participant to substantiate the hardship.
- If participant does not have documentation, employer should request repayment.
- Deferrals should be suspended for six months and reinstated at the rate of the last deferral election on file.

Best Practice

- Educate payroll/HR on hardship provisions dictated by the IRS.
- Require proof be submitted and reviewed at the governance committee level for approval prior to issuing hardship distribution.
- Understand TPA's process for issuing hardships and make sure that they will be obtaining the required documents. Ultimately as a fiduciary you will be liable for any undocumented hardship distributions.

Loans Case Study 4a – Loan payments not deducted

Scenario

- Participant borrowed money from plan in 2015. Participant made quarterly repayments throughout 2015. Participant stopped making quarterly repayments effective March 31, 2016.

Issues

- Internal Revenue Code requires systematic repayment of loans at least quarterly.

Resolution

- Reinstituted payments within six months should continue under a revised amortization schedule.

–Correction generally required before the maximum period for repayment of the loan expires.

- The loan is considered to be a deemed distribution if no payment is made for six months.

–Issue employee a Form 1099 for amount of deemed distribution.

Best Practice

- Obtain reports showing new loans issued from TPA/ Service provider.
- If loans are initiated within HR ensure a log is maintained so that loan set up can be cross checked with payroll payments.
- Request delinquent loan reports from TPA's and review them periodically.

Loans Case Study 4b – Loan payment term greater than allowable by law

Scenario

- Participant takes a loan for paying expenses other than a mortgage, with a payment term of 6 years. Participant is in the second year of repayment.

Issues

- 401(k) plan loans that are not for a residential mortgage cannot exceed a term of 5 years. Therefore, the Plan has violated regulatory provisions.

Resolution

- The participant has remaining time of 3 years on the maximum 5 years allowed and they are allowed to amortize over the remaining years to correct the error.

Best Practice

- Obtain reports showing loans issued from TPA/ Service provider and review for terms of the loans.

Audit Implications

GENERAL PROCEDURES:

•Bring the plan back to the original position as if the error/violation had not occurred.

•Reporting in the financial statements depends primarily on materiality and if the error is a prohibited transaction.

•Evaluate materiality of the error and record the amount of the correction as needed.

•Additional testing.

•Disclosure in footnotes.

•Prohibited transactions may need to be reported and disclosed on Form 5500 as well as on supplemental schedules.

•Control weakness.

•Management representation letter.

Best Practices General Guidelines

Ongoing and Regular Review Process

- Uncover potential operational errors
- Ongoing evaluation of procedures
- Minimize cost of corrections

Conducted by Independent Specialists

- Unbiased review
- No conflicts of interest

Facilitate Improvements Among All Stakeholders

- Recognize plan administration is complex
- Proactive stance is positive for all parties

Proposed Auditor’s Reporting Standard for ERISA Plans Highlights *(as currently drafted)*

Includes performance procedures relating to

- Engagement acceptance specific to ERISA plan engagements
- **Specific plan provisions relating to the financial statements (such as, eligibility, vesting, contributions, definition of compensation, allocation of plan assets to participant accounts, use of forfeitures)**
- An audit when an ERISA-permitted scope limitation is imposed
- Written representations relating to ERISA plan engagements

New report on specific plan provisions relating to the financial statements

- **Includes listing of findings from audit procedures on specific plan provisions relating to the financial statements**
- Audit procedures not designed to identify all instances
- Restricted purpose of the report on plan provisions