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Retirement PLAN news

Employee Plans Compliance Resolution System

The Employee Plans Compliance Resolution System (EPCRS) comprises three Internal Revenue Service (IRS) programs that qualified plans, 403(b) plans, SEPs, and SIMPLE IRAs can use to correct operational and plan document mistakes.

One of the major goals of EPCRS is to streamline, simplify, and expedite the process of correcting common mistakes. To that end, the IRS issues updates from time to time. The latest update, Revenue Procedure 2013-12, was issued December 31, 2012, and the changes became effective April 1, 2013. (The previous EPCRS update was May 2008.)

Following is an overview of the three programs available to plan sponsors: the Self-Correction Program (SCP), the Voluntary Compliance Program (VCP), and the Audit Closing Agreement Program (Audit CAP).

Self-Correction Program

Under SCP, a sponsor of a qualified plan that has established compliance practices and procedures may, at any time and without the threat of fees or sanctions, voluntarily correct *insignificant* operational failures that went outside the established practices and procedures. *Significant* failures may be remedied under SCP only if they are corrected within two plan years after the failure occurs. (Since ADP/ACP test failures in a 401(k) plan can be corrected within 12 months after the close of the plan year, the two-year period begins after the 12-month testing period has ended.)

Rev. Proc. 2013-12 provides specific correction methods for common mistakes that are made in plan operations. Plan sponsors are not required to disclose corrections made under SCP to the IRS. However, when using SCP, the plan sponsor should maintain adequate, detailed records to document the correction in the event the plan is subsequently audited. If the deadline for correcting a mistake under SCP has passed or a mistake is discovered that falls outside the scope of SCP, a plan sponsor can file with the IRS under the VCP.

SCP example: A 401(k) plan has established procedures for enrolling new participants. In July 2013, the plan sponsor discovers that a participant who was not eligible to enroll in the plan until July 1, 2013, was enrolled on January 1, 2013. The plan sponsor works with the plan administrator to immediately correct the mistake using the principles described under Rev. Proc. 2013-12. And, as required by EPCRS, administrative procedures are revised to ensure that this type of error does not recur. This type of mistake is eligible for correction under SCP; no additional filings or actions are needed.

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220 E. Central Parkway #3040
Altamonte Springs, FL 32701
407-875-3332
(fax) 407-875-0189

In-plan Roth "transfer"

Under the American Taxpayer Relief Act of 2012 (ATRA), an in-plan Roth 401(k) conversion now may be made as a transfer rather than as a rollover. This new provision means there does not need to be a distributable event for participants to move pretax 401(k) contributions into a Roth account with the same plan.

In-plan Roth rollover. The Small Business Jobs and Credit Act of 2010 (SBJCA) created the in-plan Roth conversion, which permits 401(k) plans (and other "applicable retirement plans") that have Roth account provisions to allow participants (or surviving spouses) to convert non-Roth accounts to Roth accounts within the 401(k) plan. Note that since funds are not distributed from the plan, the income taxes due as a result of the conversion must be paid from a participant's other assets.

There are some restrictions, however. The in-plan Roth rollover conversion is available only to participants who are eligible for a distribution from the plan. Thus, participants are not eligible to convert elective deferrals, safe harbor 401(k) contributions, qualified nonelective contributions (QNECs), or qualified matching contributions (QMACs) to a Roth account until they reach age 59½. And employer matching and nonelective contributions cannot be converted unless the plan has an in-service distribution provision.

In-plan Roth transfer. By adding the in-plan Roth transfer, ATRA eliminated the requirement that participants must have a distributable event to move pretax amounts into a Roth 401(k) account. Amounts in non-Roth accounts can now be converted by transfer. As with any Roth conversion, participants who transfer pretax amounts to after-tax Roth 401(k) accounts must pay federal income tax on the transferred amount in the year the conversion occurs.

Amending the plan. In-plan transfers are permitted only when the plan document contains or is amended to provide a Roth elective deferral feature. A plan sponsor cannot add a Roth account feature solely to allow for Roth rollovers or transfers.

Although the new law permits in-plan Roth transfers as of January 1, 2013, at press time, the IRS had yet to issue guidance on this new law change. However, based on established guidance, if a plan sponsor wishes to permit the in-plan Roth transfer, the plan document must be amended by the end of the plan year in which a Roth transfer is first permitted. Therefore, sponsors of calendar-year plans who wish to permit transfers this year will need to amend their plan by December 31, 2013. Prior to amending their plan, employers wishing to add this feature should draft a board resolution.

Note: Separate recordkeeping of each transfer is needed for reporting purposes and to track the five-year recapture tax rules.

Employee Plans Compliance Resolution System

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Voluntary Correction Program

Plan sponsors can correct mistakes that are found to be outside the scope of SCP — such as plan document failures — by using VCP. A plan sponsor may enter VCP at any time (as long as the plan has not been contacted by the IRS about an audit and is not currently under audit). After identifying the mistake, the plan sponsor proposes a correction using the principles of EPCRS and pays a compliance fee (based on the size of the plan; see article on page three). The IRS will issue a compliance statement detailing the mistake identified and the IRS-approved correction method.

Once the compliance statement is issued, the plan sponsor has 150 days to correct the mistake (if it has not already been fixed). It is much less costly to fix a mistake and receive IRS approval under VCP than to have the mistake discovered when a plan is under an IRS audit. **Note:** There are special procedures under VCP for anonymous submissions and group submissions.

VCP example: In 2013, a 401(k) plan sponsor discovers its prototype plan was never restated for EGTRRA. The deadline was April 30, 2010. This type of mistake is described under EPCRS as one that must be corrected under VCP. The plan sponsor must file a VCP application with the IRS, update the plan for EGTRRA, and pay a fee (determined by the number of participants in the plan).

Audit Closing Agreement Program

If a plan is under audit and a significant failure is identified (other than one already corrected through SCP or VCP), in order to maintain the plan's tax qualified status, the plan sponsor must correct the failure, enter into a closing agreement with the IRS, and pay a sanction. The sanction imposed will bear a reasonable relationship to the nature, extent, and severity of the failure, taking into account the extent to which the correction occurred before the audit. The sanction paid under Audit CAP is usually significantly greater than the fee that would have applied had the mistake been resolved under VCP.

Conclusion

Mistakes can and do happen. It is critical that plan sponsors follow IRS guidelines. After making corrections, plan sponsors should review their administrative practices and procedures and consider whether changes are needed to help ensure the same mistakes do not recur.

IRS
Voluntary Correction Program

The Voluntary Correction Program (VCP) is available to correct a retirement plan's more serious failures — specifically plan document failures — as well as certain demographic and operational failures that cannot be corrected under the Self-Correction Program (SCP).

With Revenue Procedure 2013-12, the IRS has streamlined the application procedure and improved the filing process for submitting corrections under VCP.* VCP is not available if a plan sponsor has been notified by the IRS that the plan is subject to an audit or if the plan is already being audited.

Document failures

One of the most common qualification failures that can be resolved under VCP is a failure to timely restate or amend a plan document for legal and regulatory changes. This is known as a nonamender failure. The IRS has a six-year remedial amendment (restatement) cycle for preapproved plan documents (prototype and volume submitter plans) and a five-year restatement cycle for custom designed plans. The categories of required changes include:

Preapproved document restatement. Restatement involves adopting a new plan document in accordance with the IRS's remedial amendment period. For preapproved plans (prototype and volume submitter plans), the most recent restatement incorporated changes made by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). The deadline to restate an EGTRRA preapproved defined contribution plan was April 30, 2010. (The deadline for an EGTRRA preapproved defined benefit plan was April 30, 2012.)

The next restatement cycle for preapproved plans is known as the Pension Protection Act of 2006 restatement. The cycle is expected to begin in 2014 and end sometime in 2016 for defined contribution plans. The IRS will announce the exact dates in early 2014. Defined benefit plans are about two years later.

Individually designed document restatement. Individually designed plans (custom designed plans) also need to be restated on a regular basis. These plans are on a five-year restatement cycle. The last digit of the employer's EIN (Employer Identification Number) determines the plan's restatement year. (EINs with a last digit of 3 or 8 are being restated in 2013.) Defined contribution and defined benefit plans are on the same cycle.

Interim amendment. This type of amendment is required by legal or regulatory changes that impact the plan document. Recent interim amendments include changes required by the Pension Protection Act of 2006 (PPA); the Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART Act); and the Worker, Retiree, and Employer Recovery Act of 2008 (WRERA). Generally, interim amendments must be made by the *later of* the last day of the plan year or the due date of the sponsoring employer's tax return for the tax year the change became effective. Sometimes a new law or regulation requires that an amendment be completed by the end of a specific plan year or by a certain date.

Discretionary amendment. Employer-level changes, such as amending a plan to allow in-plan Roth conversions or participant loans or adding a hardship withdrawal provision, require discretionary amendments. Generally, discretionary amendments must be made by the end of the plan year in which the amendment becomes effective.

If a restatement or an amendment is not made in a timely fashion, the plan is out of compliance with the Internal Revenue Code. To bring it back into compliance, the plan must be submitted to the IRS under VCP along with the applicable fee. Keep in mind that if a plan is not in compliance and it is audited, the resulting fee under the Audit Closing Agreement Program (Audit CAP) will be substantially higher than the VCP fee.

Standard VCP Fees

Number of Plan Participants	Fee
20 or fewer	$750
21-50	$1,000
51-100	$2,500
101-500	$5,000
501-1,000	$8,000
1,001-5,000	$15,000
5,001-10,000	$20,000
More than 10,000	$25,000

Standard fees

When plan sponsors file under VCP, they are required to pay a fee based on the number of participants in the plan (as reported on the plan's most recently filed annual Form 5500). The IRS provides exceptions to the standard fees for correcting certain mistakes. When one of the following is the sole plan failure, the correction qualifies for the corresponding reduced fee:

- Interim or discretionary amendment failures submitted during the plan's current remedial amendment period: $375
- Nonamender failure submitted within one year of a remedial amendment period deadline: 50% of the standard fee
- Certain plan loan failures affecting no more than 25% of the participants: 50% of the standard fee
- Required minimum distribution (RMD) operational failure under Section 401(a)(9) affecting 50 or fewer participants: $500
- 403(b) plan failure to timely adopt a written plan document prior to December 31, 2009: 50% of the standard fee if the VCP submission is made prior to December 31, 2013

* Revenue Procedure 2013-12 requires all VCP submissions to include completed Forms 8950 and 8951.

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CORPORATION
220 E. Central Parkway #3040
Altamonte Springs, FL 32701

RECENT developments

403(b) document failure correction

The long-awaited updated EPCRS (IRS Rev. Proc. 2013-12) contains a correction method for sponsors of 403(b) plans who failed to satisfy the requirements of Section 403(b) and the final 403(b) regulations by adopting a written plan document by December 31, 2009. (Prior to 2009, 403(b) plans were not subject to document requirements.) This type of failure should be corrected by adopting a written plan document and submitting an application and applicable filing fee under the IRS's Voluntary Correction Program (VCP). Plan sponsors who need to correct this type of failure are eligible for reduced penalties if they file under VCP by December 31, 2013.

Charitable donation from an IRA

Once again, the opportunity to make a charitable donation from an IRA and have it count toward an individual's required minimum distribution (RMD) has been extended for a two-year period. The most recent extension was part of the American Taxpayer Relief Act of 2012 (enacted January 2, 2013). The new law extends the provision from the end of 2011 through the end of 2013. A special transition rule enabled taxpayers to make donations before February 1, 2013, and have them treated as qualified charitable donations for the 2012 tax year.

The law essentially permits individuals age 70½ or older to make tax-free donations of up to $100,000 directly from an IRA to a qualified charitable organization (described in Section 408(d)(8)(B)(i)). Such distributions satisfy the RMD requirements for IRAs. Eligible IRA owners may take advantage of this provision regardless of whether they itemize deductions. To qualify, the funds must be transferred directly by the IRA trustee to the eligible charity. Donated amounts do not qualify for the charitable tax deduction. This type of donation is not available to individuals receiving RMDs from qualified plans; it only applies to IRAs.