EMPLOYEE PLANS COMPLIANCE RESOLUTION SYSTEM— REVENUE PROCEDURE 2008-50

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I. Introduction

The Internal Revenue Service (the Service) has updated its guidance governing its plan correction system known as the Employee Plans Compliance Resolution System (EPCRS). The guidance, reflected in Rev. Proc. 2008-50, modifies and supersedes Rev. Proc. 2006-27, 2006-22 IRB, May 5, 2006.

II. What Stays the Same

The basic organization of EPCRS remains. As such, the program still consists of:

1. The Self Correction Program;

2. The Voluntary Correction Program, and

3. Audit CAP

Rather than making wholesale changes to the program, Rev. Proc. 2008-50 provides modifications and clarifications to the rules governing the various programs. Among the more significant modifications are the following.

III. Summary of Changes under Rev. Proc. 2008-50

The Service summarizes its changes under Rev. Proc. 2008-50, as including the following:

1. expanding the definition of plan loan failure to include violations of Section 72(p)(2), regardless of whether the plan contains language relating to Section 72(p);

2. clarifying that in particular cases, the Service may decline to make available one or more correction programs under EPCRS in the interest of sound tax administration;

3. expanding the scope of SCP by: (i) liberalizing the requirements for determining whether there was substantial completion of correction as of the first date the plan or plan sponsor is considered to be under examination and (ii) expanding the failures for which sample correction methods are provided;

4. expanding the correction method with respect to elective deferrals to include catch-up contributions under Section 414(v) and plans that provide the opportunity for an employee to designate all or a portion of elective deferrals as designated Roth contributions;

5. expanding the correction method for a failure to include an eligible employee in a Section 401(k) plan to include a situation in which elective deferral and after-tax employee contribution elections are not implemented by the employer or are implemented in a manner inconsistent with the plan's terms;

6. revising the requirements for submitting a determination letter application when correcting certain qualification failures by plan amendment;

7. clarifying the scope of a compliance statement issued when correcting certain qualification failures by plan amendment;

8. updating the definition of excess amounts and providing corrections for excess amount failures, including those resulting from the failure to satisfy the requirements of Section 415; this update includes correction rules largely similar to the corrections that were at Treas. Reg. Section 1.415-6(b)(6)(iii) prior to amendments made by the recently finalized regulations, but with the amount placed in an unallocated account to be reallocated in lieu of employer contributions other than elective deferrals;

9. updating the definition of favorable letter;

10. adding a factor to be considered in the determination of whether a correction method is reasonable and appropriate; the factor requires consideration of corrections of violations that are similar to the failure being addressed by other governmental agencies; in appropriate cases,

for a failure that results from either the employer having ceased to exist, the employer no longer maintaining the plan, or similar reasons, the permitted correction would be to terminate the plan and distribute plan assets to participants and beneficiaries to those set forth in Section 2578.1 of the Department of Labor regulations (relating to abandoned plans);

11. clarifying that the earnings adjustment for corrective contributions or distributions is calculated from the date when the qualification failure occurred without regard to any extensions provided under the Code;

12. clarifying that the earnings rate derived from the Department of Labor's VFCP Online calculator may be used to determine the earnings adjustment applied to corrective contributions, distributions, allocations, and reallocations if it is not feasible to make a reasonable estimate of what the actual investment results would have been;

13. providing that if the total corrective distribution due to a participant or beneficiary is $75 or less, the plan sponsor is not required to make the corrective distribution if the reasonable direct costs of processing and delivering the distribution to the participant or beneficiary would exceed the amount of the distribution;

14. providing that if the plan sponsor attempts the IRS' Letter Forwarding Program to locate participants and the Service declines to implement the letter forwarding request, then the plan sponsor will use alternate means to locate missing participants;

15. clarifying that if a plan sponsor either: (i) wants a participant's deemed distribution to be reported on Form 1099-R for the year of correction (instead of the year of the failure) or (ii) wants relief from reporting a participant's loan as a deemed distribution on Form 1099-R, then it must specifically request such relief;

16. clarifying the treatment of amounts improperly distributed to participants and beneficiaries under the plan which are rolled over to IRAs, with respect to the excise tax under Section 4973;

17. clarifying the circumstances under which a waiver of the excise tax under Section 4974 would be considered under Audit CAP;

18. expanding the income and excise taxes that the Service may exercise discretion to not pursue;

19. clarifying the scope of a compliance statement issued with respect to certain nonamender failures;

20. providing for new and expanded streamlined application procedures for interim nonamenders and the failure to implement optional law changes timely and other nonamenders, certain SEP, SARSEP and SIMPLE IRA failures, certain plan loan failures, Employer Eligibility Failures, Section 402(g) failures, Section 401(a)(9) failures and failures that involve plan amendment in accordance with Appendix B 2.07;

21. reducing the compliance fee under certain circumstances for a plan where the sole failure is the failure of participant loans to comply with the requirements of Section 72(p)(2);

22. clarifying that, in the case of a qualification failure that is intentional, the compliance fee under VCP will be determined in accordance with Section 12.06 (that is, the VCP fee for egregious or intentional failures);

23. providing that Audit CAP provisions apply if the Service identifies a participant loan that did not comply with the requirements of Section 72(p)(2) (other than a loan failure that is corrected in accordance with SCP or VCP) upon an Employee Plans or Exempt Organizations examination of a qualified plan or Section 403(b) Plan, and

24. providing a sample application form for VCP filings.

[Rev. Proc. 2008-50, Part I, Section 2.01

IV. Expanded Review of Select Changes Summarized

A. Additional Restriction on Availability of EPCRS

Rev. Proc. 2006-27 added restrictions under each of the sub-programs on the availability of the programs where the plan or plan sponsor is deemed to have

engaged in certain transactions viewed by the Service as abusive or tax avoidance transactions.

Revenue Procedure 2008-50 retains these provisions and adds an additional restriction.

Specifically, Revenue Procedure 2008-50 provides that the Service reserves the right to decline to make available one or more correction programs where it determines that such is in the interest of sound tax administration. [Rev. Proc. 2008-50, Part II, §4.01(5)]

B. Changes to Correcting Loan Failures

Background

Revenue Procedure 2006-27 added specific rules governing loan failures including:

1. loans that exceed the maximum permitted amount where the terms of the plan require that loans comply with Section 72(p)(2)(A);

2. loans that fail to satisfy the term requirement or the level amortization requirements of Section 72(p)(2)(B) and (C), and

3. certain defaulted loans.

The loan correction methods are available if corrected under VCP and are generally available where the maximum repayment period under the statute has not expired.

Revenue Procedure 2008-50 makes the following changes to the rules governing loan failure correction.

Extension to Situations where Plan does Not Require Compliance with Section 72(p)(2)

Revenue Procedure 2008-50 extends the loan correction provisions to situations in which the plan does not require loans to satisfy the requirements of Section 72(p)(2). Thus, those looking to correct loan failures will not be required to demonstrate a true qualification failure (i.e, the Operational Failure of the failure to

follow the terms of the plan) in order to be allowed to make this correction. However, the revenue procedure goes on to provide that to correct the ERISA fiduciary violations associated with the failures to satisfy the maximum loan amount, or the term or level repayment requirements of Sections 72(p)(2)(B) or (C) or in the case of a loan default under the DOL's Voluntary Fiduciary Correction Program, the plan must contain plan provisions requiring that loans comply with Section 72(p)(2)(A), (B) and (C). [Rev. Proc. 2008-50, Part III, §6.07(2)(d)]

Reporting of Loan Failures

Unless correction is made in accordance with EPCRS, a deemed distribution under Section 72(p)(1) in connection with a loan failure must be reported on Form 1099-R and any applicable income tax withholding that was required to be paid in connection with the failure must be paid by the employer. [Treas. Reg. §1.72(p)-1, Q & A-15]

As part of a submission and correction under VCP of a loan failure, the deemed distribution may be reported on Form 1099-R with respect to the affected participant for the year of correction, instead of the year of the failure. However, Revenue Procedure 2008-50 claries that this relief is only available if the plan sponsor specifically requests the relief. [Rev. Proc. 2008-50, part III, §6.07(1)]

Moreover, a deemed distribution corrected under Section 6.07(2)(b) or (c) [i.e., a failure to comply with the maximum loan provisions contained in the plan, or loans that fail to satisfy the term requirements or the level amortization requirements of Sections 72(p)(2)(B) or (C)] or with Section 6.07(3) [i.e., defaulted loans provided the maximum statutory repayment period has not expired] is not required to be reported on Form 1099-R. However, again, this relief is only available, as clarified by Revenue Procedure 2008-50, if the plan sponsor specifically requests such relief and provides an explanation supporting the request. [Rev. Proc. 2008-50, part III, §6.07(2)(a)]

Reduced Compliance Fee

Revenue Procedure 2008-50 adds a new reduced fee for the correction of certain loan failures under VCP.

If a VCP submission involves: (1) the failure of participant loans to comply with the requirements of Section 72(p)(2); (2) the failure does not affect more than 25% of the plan's participants in any of the year(s) in which the failure occurred, and (3)

the failure is the only failure of the submission, the VCP fee is the normal fee determined under the general rule reduced by 50%. [Rev. Proc. 2008-50, Part V, § 12.02(3)]

C. Changes to Overriding Correction Principles

Date of calculation of Earnings for Corrective Contributions or Distributions

Revenue Procedure 2008-50 clarifies that, in the case of a defined contribution plan, a corrective contribution or distribution should be adjusted for earnings (including losses) from the date of the failure, determined without regard to any Code provision which permits a corrective contribution or distribution to be made at a later date.

Taking Into Account DOL or Other Agency Correction Methods

Added to its list of overriding Correction Principles and Rules, Revenue Procedure 2008-50 provides that if a correction method is one which another governmental agency has authorized with respect to a violation of legal requirements within its interpretive authority and that correction relates to a violation for which there is a failure to which EPCRS applies, then the Service may take the correction method of the other governmental agency into account for purposes of EPCRS.

This might occur, for example, where the DOL's rules governing abandoned plans come into play or in the case of a violation of ERISA's fiduciary duty requirements. In the latter case, correction under the DOL's Voluntary Fiduciary Correction Program for which there is a similar failure under EPCRS would generally be taken into account as correction under Revenue Procedure 2008-50.

[Rev. Proc. 2008-50, Part III, §6]

Calculating Earnings Adjustments

Under prior guidance, if either: (i) it is possible to make a precise calculation but the probable difference between the approximate and the precise restoration of a participant's benefits is insignificant and the administrative cost of determining precise restoration would significantly exceed the probable difference or (ii) it is not possible to make a precise calculation (for example, where it is impossible to provide plan data), reasonable estimates may be used.

Revenue Procedure now provides that if it is not possible to make a reasonable estimate of what the actual investment results would have been, a reasonable interest rate may be used. For this purpose, the interest rate used by the DOL's Voluntary Fiduciary Correction Program Online Calculator is deemed to be a reasonable interest rate. [Rev. Proc. 2008-50, Part III, §6.02(5)(a)]

De Minimis Rule—Delivery of Small Benefits

Under a modified de minimis rule under prior guidance, where the corrective distribution due a participant or beneficiary is $50 or less but the reasonable direct cost of processing and delivering the distribution would exceed the amount of the distribution, the plan sponsor is not required to make the corrective distribution.

Revenue Procedure 2008-50 increases this amount to $75. [Rev. Proc. 2008-50, Part III, §6.02(5)(b)]

Missing Participants

Where reasonable actions have been taken to locate a participant or beneficiary to whom a corrective distribution is due, but who has not been located after a mailing to the last known address, the plan sponsor will not be deemed to have failed to make full correction merely because it could not locate such participant or beneficiary. Under this exception, reasonable efforts to locate should generally include such things as mailing notice to the last known address and using the IRS' or the Social Security Administration's letter-forwarding programs.

Revenue Procedure 2008-50 notes that, on occasion, the Service may decline to perform the letter forwarding request, even if additional benefits are due to participants. In such a situation, it is expected that the plan sponsor will take other reasonable actions to locate participants to whom additional benefits are due. [Rev. Proc. 2008-50, Part III, §6.02(5)(d)]

D. Changes to SCP

SCP actually itself consists of two sub-programs: (a) the correction of Insignificant Operational Failures sub-program (where the failures can be corrected at any time) and the correction of Significant Operational Failures sub-program.

With respect to the correction of Significant Operational Failures, the correction is time limited.

Specifically, the Significant Failures component of SCP requires that the correction either be completed or substantially completed by the last day of the correction period. Generally, the last day of the correction period is the last day of the second plan year following the plan year in which the failure occurred. However, in all events, the correction period will end on the first date the plan or plan sponsor is deemed to be under examination for that plan year. [Rev. Proc. 2008-50, Part IV, §9.02(3)] Note, however, that if the correction has been substantially completed before the plan is under examination, it can be completed even while the plan is under examination.

Correction Substantially Completed

Correction will be deemed to be substantially completed by the last day of the correction period if either (1) or (2) are satisfied:

1. (a) during the correction period, the plan sponsor is reasonably prompt in identifying the Operational Failure, formulating a correction method, and initiating correction in a manner that demonstrates a commitment to completing correction as expeditiously as practicable, and (b) within 120 days (prior to Rev. Proc. 2008-50, the period was 90 days) after the last day of the correction period, the plan sponsor completes correction, or

2. (a) during the correction period, correction is completed with respect to 65% (prior to Rev. Proc. 2008-50, 85%) of all participants affected by the Operational Failure, and (b) thereafter, the plan sponsor completes correction of the failure with respect to the remaining affected participants in a diligent manner.

[Rev. Proc. 2008-50, Part IV, §9.04]

E. Changes to Audit CAP

Application to Loan Failures

Revenue Procedure 2008-50 provides that Audit CAP also applies if the Service identifies a participant loan that did not comply with the requirements of Section 72(p)(2) (other than a loan failure that is corrected in accordance with SCP or VCP) upon examination. [Rev. Proc. 2008-50, Part VI, §13.01]

Waiver of Section 4974 Excise Tax

Revenue Procedure 2008-50 provides that the excise tax under Section 4974 (i.e., the required minimum distribution excise tax) will only be waived if the sponsor makes a specific request for the waiver. [Rev. Proc. 2008-50, Part III, §6.09(2)]

Correction by Amendment

A plan sponsor may use Audit CAP to correct Plan Document, Demographic and Operational Failures by plan amendment, including correcting an Operational Failure by plan amendment to conform to the terms of the plan's prior operations, provided the amendment complies with the requirements of Section 401(a), including the requirements of Section 401(a)(4), 410(b) and 411(d)(6). In addition, a plan sponsor may amend the plan to the extent necessary to reflect the corrective action. [Rev. Proc. 2008-50, Part II, § 4.05(1)]

F. Expansion of Possible Waiver of Excise Taxes

Section 4973

Except with respect to the special rules that apply in correcting an Employer Eligibility Failure, as part of VCP, in appropriate cases, Revenue Procedure 2008-50 provides that the Service will not pursue the excise tax under Section 4973 (relating to excess contributions made to an IRA) under any of the following circumstances:

(a) as part of the proposed correction for Overpayments, the participant or beneficiary ("recipient") removes the Overpayment (plus earnings) from the recipient's IRA and returns that amount to the plan;

(b) as part of the proposed correction for Excess Amounts, the recipient removes the Excess Amount (plus earnings) from the recipient's IRA and reports that amount (reduced by any applicable after-tax employee contribution) as a taxable distribution for the year in which the Excess Amount (plus earnings) is removed from the recipient's IRA. The amount removed will generally be taxed in a manner that is similar to the manner in which the corrective disbursement of elective deferrals is taxed, as described in section 3 of Rev. Proc. 92-93; or

(c) in the case of an Overpayment that was not made pursuant to a distributable event, the plan sponsor, as part of the submission, must request relief from the § 4973 excise tax and provide an explanation supporting the request.

[Rev. Proc. 2008-50, Part III, §6.09(5)]

Section 72(t)

As part of VCP, in appropriate cases, Revenue Procedure 2008-50 provides that the Service will not pursue the 10% early distribution tax of Section 72(t) (or will pursue only a portion thereof) if, as part of the proposed correction for Overpayments that were not made pursuant to a distributable event, the participant or beneficiary removes the amount improperly distributed and rolled over (plus earnings) from the recipient's IRA and returns that amount to the plan. In appropriate cases, as a condition for not pursuing all or a portion of the additional tax, the Service may require the plan sponsor to pay an additional fee under VCP not in excess of the 10% additional income tax under Section 72(t). The plan sponsor, as part of the submission, must request the relief and provide an explanation supporting the request. [Rev. Proc. 2008-50, Part III, §6.09(6)]

G. Determination Letter Application Filing Requirements

SCP Correction by Retroactive Amendment

In order to complete correction by plan amendment under SCP, the appropriate determination application must be submitted before the end of the plan's remedial amendment period as described in Rev. Proc. 2007-44. [Rev. Proc. 2008-50, Part II, §4.05(2) and Part IV, § 9.03]

As part of the determination letter submission, the cover letter must identify the amendment as a corrective amendment under SCP. In addition, the sponsor must include in the cover letter to the application: (1) a statement that neither the plan nor the plan sponsor has been a party to an abusive tax avoidance transaction (as defined in section 4.13(2) of the revenue procedure); or (2) a brief identification of any abusive tax avoidance transaction to which the plan or the plan sponsor has been a party.

Under VCP

Revenue Procedure 2008-50 adds clarifying information on the submission of a determination letter application where one is required to be submitted. The requirement to file a determination letter application as part of VCP is generally in the case where a Qualification Failure is corrected by plan amendment other than an amendment designated by the Service as a model amendment or the adoption of a prototype or volume submitter plan for which the sponsor has reliance. The plan sponsor must submit a copy of the applicable determination letter application (i.e., 5300, 5307 or 5310), the appropriate user fee to the same address as the VCP filing. Form 6406 will no longer be accepted. [Rev. Proc. 2008-50, Part V, §11.04(2)] The VCP fee and the determination letter user fee must be submitted by separate checks. [Rev. Proc. 2008-50, Part V, §11.05]

Revenue Procedure 2008-50 contains significantly more information as to the application of the determination letter procedures and rules in the context of a VCP submission.

First, Section 6.05 of the Revenue Procedure sets forth the situations in which a determination letter application is required to be submitted as part of the correction of a Qualification failure under VCP that involves a plan amendment. If a determination letter is required under Section 6.05, then, unless otherwise specified in the revenue procedure, the provisions of Rev. Proc. 2007-44 will apply. This means, for example, in the case of an ongoing individually designed plan, a determination letter application will be reviewed with respect to all items of the Cumulative List (as defined in Rev. Proc. 2007-44) that would apply to the remedial amendment cycle during which the determination letter is filed.

However, a determination letter is not required if the correction by plan amendment is achieved through either the adoption of an amendment that is designated as a model amendment by the Service or the adoption of a prototype or volume submitter plan with an opinion or advisory letter as provided in Rev. Proc. 2008-6, 2008-1 I.R.B. 192, on which the plan sponsor has reliance.

Application to VCP and CAP

On-Cycle Correction

Revenue Procedure 2008-50 provides that, in the case of either VCP or CAP, a determination letter application is required if the plan sponsor submits the failure under VCP or corrects the failure under Audit CAP during an on-cycle year or in connection with a plan termination. An "on-cycle year" means the last 12 months of the plan's remedial amendment cycle set forth in Rev. Proc. 2007-44.

Special Rule for Nonamenders

Further, a determination letter application is required to correct a nonamender failure under VCP or Audit CAP, whether or not the plan is submitted under VCP or corrected under Audit CAP during an on-cycle year. For this purpose, the term "nonamender" means a failure to amend a plan to correct a disqualifying provision described in Treasury Regulation 1.401(b)-1(b) within the applicable remedial amendment period.

Off-Cycle other than Nonamenders

If on any date that is prior to or after the plan's on cycle year (i.e., during an "off-cycle "year), a plan sponsor submits a failure under VCP or corrects a failure under Audit CAP to adopt timely interim amendments or timely amendments to the plan to implement optional law changes, then a determination letter application is not required and should not be submitted with the VCP submission or as part of the correction of the failure under Audit CAP.

In order to ensure that the corrective amendment adopted for this failure complies with the change in qualification requirement, the plan sponsor should include the corrective amendment along with the compliance statement or closing agreement, with its application for a determination letter during the plan's on-cycle year or if earlier, in connection with the plan's termination. This provision is applicable only if the VCP application setting forth the interim or optional law change failure is submitted, or the Audit CAP correction is made, prior to the plan's first on-cycle year following the date by which the amendment for the interim or optional law change should have been adopted pursuant to section 5.05 of Rev. Proc. 2007-44.

However, these rules only apply if the VCP application setting forth the interim or optional law change failure is submitted, or the Audit CAP correction is made, prior to the plan's first on-cycle year following the date by which the amendment for the interim or optional law change should have been adopted pursuant to Section 5.05 of Rev. Proc. 2007-44.

Operational or Demographic Failures Corrected Through Plan Amendment

If, during an off-cycle year, a plan sponsor submits an Operational or Demographic Failure under VCP or corrects such a failure under Audit CAP, then a determination letter application is not required and should not be submitted with the VCP submission or as part of the correction of the failure under Audit CAP. If the plan amendment is accepted as a proper correction for either an Operational Failure or a Demographic Failure, the Compliance Statement under VCP or Closing Agreement issued under Audit CAP constitutes a determination on the effect of the plan amendment on the qualification of the plan; however, the Compliance Statement issued under VCP is subject to the condition that the amendment be submitted as part of a separate determination letter submission during the plan's next on-cycle

year, or if earlier, in connection with the plan's termination, and that a favorable determination letter be issued with respect to the plan.

A plan sponsor that corrects an Operational Failure or Demographic Failure through a plan amendment under Audit CAP during an off-cycle year should also include a copy of the closing agreement when submitting a determination letter application during the plan's next on-cycle year, or if earlier, in connection with the plan's termination.

Optional Determination Letter Applications

A plan sponsor may submit a determination letter application with respect to the correction of failures through plan amendment prior to the plan's on-cycle year if the plan would be given the same priority as an on-cycle filing pursuant to sections 14.02 and 14.03 of Rev. Proc. 2007-44, relating to certain new plans, terminating plans, and off-cycle applications submitted in accordance with published guidance issued by the Service specifying such submission, and in the case of urgent business need.

Determination letter requests submitted pursuant to this provision must contain a written justification as to the eligibility of the plan under section 14.02 or 14.03 of Rev. Proc. 2007-44 and this section 6.05(4). In the case of urgent business need, the Service will consider such requests based on the facts and circumstances.

IRS Discretion

Notwithstanding the rules above, the Service reserves the right to require the submission of a determination letter application with respect to any amendment proposed or adopted to correct any Qualification Failure under VCP or Audit CAP.

[Rev. Proc. 2008-50, Part III, §6.05]

H. Changes to VCP Submission Procedure

Revenue Procedure 2008-50 contains new Appendix D and F provided to assist in the submission process. While not mandated to be used, the applicants are encouraged to use Appendix D and F as applicable.

If the Streamlined Application procedure is used, the applicant is to use Appendix F and related schedules. Otherwise, the application should be made in accordance with the provisions of Section 11.03 of the revenue procedure using the format outlined in Appendix D.

The Appendix D and F formats for the application should not be modified.

[Rev. Proc. 2008-50, Part V, §11.01]

If all of the Qualification Failures the plan sponsor proposes to correct through VCP are described below and the plan sponsor proposes to correct using a correction method provided in Appendix F, then the submission should be made pursuant to these streamlined procedures.

A Streamlined Application consists of the Appendix F, the appropriate schedules for the failures and all other documents required as indicated on the applicable schedule.

The failures eligible for the Streamlined Application procedure are:

1. Failure to adopt interim amendments or amendments required to reflect the changed operation of the plan on account of the plan sponsor's decision to implement optional law changes as described in Section 6.05(3)(b) of the revenue procedure;

2. Failure to timely adopt amendments to comply with required legislative or regulatory changes;

3. Failure to administer loans in accordance with the provisions of Section 72(p), the failure solely relates to employees who are neither key employees nor self employed;

4. Failure to satisfy the criteria for an employer to sponsor a Section 401(k) plan;

5. Failure to distribute elective deferrals made in excess of the Section 402(g) limit and the sponsor proposes to

correct such failure using the method described in Appendix A, Section .04;

6. Failure to make required minimum distributions and the sponsor proposes to correct such failure using the method described in Appendix A, Section .06;

7. One or more of the failures eligible for correction by retroactive amendment under SCP reflected in Section 2.07 of Appendix B.

[Rev. Proc. 2008-50, Part V, §11.02]

I. Section 401(k) Changes

Missed Opportunity to Make Catch-Up Contributions

Revenue Procedure 2008-50 includes additional sample corrections with respect to failures under Section 401(k) plans including where a catch-up eligible employee is provided the opportunity to make elective deferrals up to the plan's limit but not the opportunity to make catch-up contributions.

Essentially, the approved correction requires that the employer make a contribution of a QNEC to the plan on behalf of the employee to replace the "missed opportunity" attributable to the failure to permit the employee to make a catch-up contribution, i.e., 50% of the missed deferral attributable to the catch-up contribution, that is, 50% of the applicable catch-up limit for the year adjusted for earnings.

In addition, the employer must also determine if the employee would have been entitled to an additional matching contribution, and if so, the employer must make the additional QNEC as a match. The QNEC is equal to the additional match the employee would have received had the employee made the deferral equal to the missed deferral, adjusted for earnings. [Rev. Proc. 2008-50, Appendix A, Section .05(4); Appendix B, Section 2.02(b), Example 11]

Failure to Implement Employee Election

In addition, the new revenue procedure includes approved corrections and sample corrections for correcting a failure to follow an employee's elective deferral elections. In such case, the employer must make a QNEC on behalf of the affected employee equal to the employee's "missed deferral" opportunity deemed to be 50% of the employee's missed deferral, adjusted for earnings. If the missed election involves after-tax contributions, the missed deferral opportunity is deemed to instead be 40% of the missed after-tax contributions. If the employee would have been entitled to an additional matching contribution, then the employer must also make a QNEC equal to the matching contribution equal to matching contribution the employee would have received had the employee made a deferral equal to the missed deferral determined above. [Rev. Proc. 2008-50, Appendix A, Section .05(5); Appendix B, Section 2.02(b), Example 12]

Improperly Excluded from Roth Amounts

Appendix A provides that generally for employees improperly excluded from a Section 401(k) plan containing a Roth feature, the correction is generally the same as that described for the exclusion from before-tax contribution Section 401(k) plans. This means, for example, that the corrective employer contribution required to replace the missed deferral opportunity is made in accordance with the methods that apply in the case of a non-safe harbor before-tax Section 401(k) plan or a safe harbor before-tax contribution Section 401(k) plan, as applicable.

However, none of the corrective contributions made by the employer may be treated as designated Roth contributions (and may not be included in an employee's gross income) and thus may not be contributed or allocated to a designated Roth account. The corrective contribution must be allocated to an account established for receiving a QNEC or any other employer contribution in which the employee is fully vested and subject to the withdrawal restrictions that apply to elective deferrals. [Rev. Proc. 2008-50, Appendix A, Section .05(3)]

V. Other Changes of Note

A. Overriding Principles—Small Overpayment Rule

Two governing principles that previously were, by their terms, not available under SCP have now been revised so that the restriction to VCP and CAP only no longer applies.

Specifically, first, under Revenue Procedure 2006-27, for submissions under the VCP program of under CAP, that revenue procedure provided that if the total amount of an overpayment made to a participant or beneficiary was $100 or less, the plan sponsor was not required to seek the return of the overpayment and was not required to notify the participant or beneficiary that the overpayment is not eligible for favorable tax treatment. [Rev. Proc. 2006-27, Part III, Section 6.02(5)(c)]

Revenue Procedure 2008-50 no longer contains the restriction limiting this provision to submissions under VCP or to processing under CAP. [Rev. Proc. 2008-50, Part III, Section 6.02(5)(c)]

B. Overriding Principles—Small Excess Amount

Similarly, under Revenue Procedure 2006-27, under a special rule applicable to VCP or CAP, if the total amount of an Excess Amount with respect to the benefit of a participant or beneficiary was $100 or less, the sponsor was not required to distribute or forfeit such Excess Amount. However, if the Excess Amount exceeded a statutory limit, the participant or beneficiary was required to be notified that the Excess Amount, including earnings, was not eligible for favorable tax treatment and specifically, was not eligible for tax-free rollover. [Rev. Proc. 2006-27, Part III, Section 6]

The prior language, restriction this rule to VCP and CAP is removed under Revenue Procedure 2008-50. [Rev. Proc. 2008-50, Part III, Section 6.02(5)(e)]

C. Correction of Section 415 Violations in Defined Contribution Plans

Background

The 1981 final Section 415 regulations contained specified methods for correcting Section 415 annual addition failures which defined contribution plans were allowed to include in their documents and implement. Such correction methods included the maintenance of a plan suspense account. The correction was essentially self-administered by plans.

However, as a result of its separate and more comprehensive correction program, the Service has instead concluded that all such corrections should be housed in a single vehicle as part of the Employee Plans Compliance Resolution System (i.e., "EPCRS"). As a result, these Section 415 corrective procedures are no longer contained in the final regulations.

However, according to the Preamble to the 2007 final Section 415 regulations, despite the deletion, the deleted correction methods could then still generally to be permitted under EPCRS.

Specifically, in accordance with the Preamble, pending the issuance of further guidance, plans that are eligible for self correction under EPCRS (i.e., under section 4 of then Rev. Proc. 2006-27) could implement correction using the methods contained in former Treas. Reg. Section 1.415-6(b)(6), but only if the requirements of section 9 of the revenue procedure were satisfied, and those corrections will be taken into account for purposes of the Voluntary Correction and Audit Closing Agreements component of the Employee Plans Compliance Resolution System. [See Preamble to Final Section 415 Regulations, TD 9319, Limitations applicable to defined contribution plans]

Revenue Procedure now allows for correction of Section 415 violations as part of EPCRS. This means that a defined contribution plan can self correct these failures provided it otherwise satisfies the requirements for self correction.

Expanded Definition of Excess Amount

Revenue Procedure 2008-50 expands the definition of Excess Amounts. The term now means a Qualification Failure due to a contribution, allocation, or similar credit that is made on behalf of a participant or beneficiary to a plan in excess of the maximum amount permitted to be contributed, allocated, or credited on behalf of the participant or beneficiary under the terms of the plan or that exceeds a limitation on contributions or allocations provided in the Code or regulations. The term "Excess Amounts" expressly includes: (i) both an elective deferral or after-tax employee contribution made in excess of the limitation under § 415, as well as (ii) any employer contribution that exceeds a limitation under §415. [Rev. Proc. 2008-50, Part III, §5.01(3)]

Reduction of Account Balance Correction Method

In general, an Excess Allocation is corrected in accordance with the Reduction of Account Balance Correction Method.

Under this method, the account balance of an employee who received an Excess Allocation is reduced by the Excess Allocation (adjusted for earnings).

If the Excess Allocation would have been allocated to other employees in the year of the failure had the failure not occurred, then that amount (adjusted for earnings) is reallocated to those employees in accordance with the plan's allocation formula.

If the improperly allocated amount would not have been allocated to other employees absent the failure, that amount (adjusted for earnings) is placed in a separate account that is not allocated on behalf of any participant or beneficiary (an unallocated account) established for the purpose of holding Excess Allocations, adjusted for earnings, to be used to reduce employer contributions (other than elective deferrals) in the current year or succeeding year(s). While such amounts remain in the unallocated account, the employer is not permitted to make contributions to the plan other than elective deferrals.

Excess Allocations that are attributable to elective deferrals or after-tax employee contributions, (along with earnings attributable thereto) must be distributed to the participant.

For qualification purposes, an Excess Allocation that is corrected pursuant to this paragraph is disregarded for purposes of § 402(g), §415, the actual deferral percentage test of § 401(k)(3), and the actual contribution percentage test of § 401(m)(2).

If an Excess Allocation resulting from a violation of § 415 consists of annual additions attributable to both employer contributions and elective deferrals or after-tax employee contributions, then the correction of the Excess Allocation is completed by first distributing the unmatched employee's after-tax contributions (adjusted for earnings) and then the unmatched employee's elective deferrals (adjusted for earnings).

If any excess remains, and is attributable to either elective deferrals or after-tax employee contributions that are matched, the excess is apportioned first to after-tax employee contributions with the associated matching employer contributions and then to elective deferrals with the associated matching employer contributions. Any matching contribution or nonelective employer contribution (adjusted for earnings) which constitutes an Excess Allocation is then forfeited and placed in an unallocated account established for the purpose of holding Excess Allocations to be used to reduce employer contributions in the current year and succeeding year(s). Such unallocated account is adjusted for earnings. While such amounts remain in the unallocated account, the employer is not permitted to make contributions (other than elective deferrals) to the plan.

VI. Effective Date

Revenue Procedure 2008-50 is generally effective January 1, 2009. However, plan sponsors are permitted, at their discretion, to apply the provision of the revenue procedure on or after September 2, 2008. [Rev. Proc. 2008-50, Part VII, Section 16]