I. Introduction

Over the course of the life of a retirement plan, plan sponsors and fiduciaries may discover defects either in form (that is, plan document failures) or in the operation of the plan. Such defects may result in the loss of tax qualification and/or potential personal liability on the part of plan fiduciaries. In order to allow for the correction of certain defects, both the Internal Revenue Service (the IRS) and the Department of Labor (DOL) have adopted certain correction programs which may be available to plans to correct some defects.

However, with respect to tax qualification failures, not all of these correction programs actually require IRS involvement.

II. Auditing The Plan for Compliance

A. What the loss of Tax Qualification Means

Plan sponsors and their advisors must avoid having plan failures discovered by the IRS as such failures can result in the loss of tax qualification.

The loss of tax qualification means that:

1. the trust must pay taxes on its earnings due to the revocation of its tax exempt status;
2. employees will be taxed on their interest in accordance with Section 83 meaning that employees will be taxed on their vested interest, and
3. deductions for contributions by the employer for any open years will be lost or at best deferred

[IRC Section 402(b); IRC Section 403(c); IRC Section 404(a)(5); Treas. Reg. Section 1.402(b)-1]

With respect to the deduction for employer contributions made to a disqualified plan, the general rules governing the symmetry between the timing of a deduction taken and income inclusion means that the employer’s contribution is deductible in the year that the participant includes the amount in income under Section 83. [IRC Sections 402(b), 403(c), 404(a)(5)] However, this rule is only available if, in the case of a plan that has more than one participant separate accounts are maintained for each participant. [IRC Section 404(a)(5)] Thus, in the case of a disqualified defined benefit plan, deductions may well be completely lost. [Private Letter Ruling 7904042 (October 25, 1978)]
Moreover, it is the IRS’ view that once the plan ceases to be tax qualified, absent a special program that can properly requalify the plan, the plan remains disqualified and the taxation of all amounts under the plan, even if contributed when the plan was in fact qualified, is to be governed by the status of the plan at the time of distribution. This means then that the distribution is taxed as ordinary income and cannot be rolled over. [Treas. Reg. Section 1.402(b)-1(c)(1); see also, Fazi v. Comm, 102 TC 695 (1994); Woodson et al. v Comm., (651 F. 2d 1094 (5th Cir. 1981); Benbow v Comm. (1985, CA7), 56 AFTR 2d 85-5998)]

If discovered on audit, the plan sponsor may be confronted with a choice of the total disqualification of the plan or payment of a significant monetary sanction as part of the price to requalify the plan in addition to correcting all plan errors.

B. What Is a Plan Failure

Plainly put, a plan failure is any deviation from either the terms of the plan or the statutory or regulatory requirements applicable to the plan.

There are four types of failures that can cause a plan to cease to be tax-qualified:

1. Plan Document Failure;
2. Operational Failure;
3. Demographic Failure, and
4. Employer Eligibility Failure.

1. What is a Plan Document Failure?

The term “Plan Document Failure” means a plan provision (or the absence of a plan provision) that, on its face, violates the requirements of § 401(a), that is, the qualification requirements. [Rev. Proc. 2008-50, Part III, Section 5.01(2)(a)]

Plan Document Failures usually arise in two basic situations: (1) where a new law passes or regulations are issued and the plan fails to be amended timely to reflect the new qualification requirement within the plan's applicable remedial amendment period under § 401(b), or (2) where the plan has not been timely or properly amended during an applicable remedial amendment period for adopting good faith or interim amendments.

**Example 1:** Congress enacts the Economic Growth and Tax Relief Reconciliation Act of 2001. The IRS announces that individually designed plans must adopt interim, or good faith amendments, to comply with the provisions of the Act not later than the last day of the 2001 plan year. Widget maintains an individually designed Section 401(k) plan that operates on the calendar year. The plan is not amended to comply with the new law by December 31, 2001. The plan ceases to be tax qualified as a result of this Plan Document Failure.
2. What is an Operational Failure?

An “Operational Failure” means a failure (other than an Employer Eligibility Failure defined below) that arises solely from the failure to follow plan provisions. [Rev. Proc. 2008-50, Part III, Section 5.01(2)(b)] An Operational Failure is perhaps the most common type of failure. Essentially, it is any sort of disconnect between what the plan says should happen, and the plan’s actual operation. An Operational Failure can arise even where the term of the plan that was not properly followed is itself not a condition of tax qualification.

**Example 2:** ABC maintains a profit sharing plan that includes language allowing for participant loans. That plan’s provision provides that the loan must, in accordance with Section 72(p) of the Code, be both repaid and repayable over 5 years in substantially equal quarterly installments of principle and interest. Chris, a participant in the plan with an outstanding loan, misses two quarterly payments and the loan is declared to be in default by the plan.

Chris is taxed currently on the unpaid balance of principle and interest.

The plan is audited and the IRS agent also concludes that the plan is disqualified because the plan has experienced an Operational Failure. Although the terms of the plan, which simply mirrored the statutory provisions, required quarterly repayments of principle and interest, Chris’ failure means that the provision was not complied with in operation.

**Example 3:** ABC maintains a money purchase plan that provides for a contribution of 5% of each employee’s compensation. After an especially good year, ABC actually contributes 15% of each employee’s compensation, but forgets to amend the plan’s contribution provisions. Despite the good news to employees, the plan has ceased to be tax qualified due to the Operational Failure of the failure to follow the terms of the plan.

3. What is a Demographic Failure?

A “Demographic Failure” essentially means a failure to satisfy one of the basic demographic requirements that apply to the plan. In the case of a qualified plan, this means either the failure to satisfy the nondiscrimination requirements of Section 401(a)(4), the minimum participation requirements applicable to defined benefit plans of Section 401(a)(26) or the minimum coverage requirements of Section 410(b). [Rev. Proc. 2008-50, Part III, Section 5.01(2)(c)]

**Example 4:** ABC, a construction company, maintains a Section 401(k) plan for its employees. The plan has never been extended however, to the DEF subsidiary. ABC incorrectly believed that it need not provide benefits for employees of a separate entity even though that separate entity is part of the same controlled group as ABC. When the minimum coverage test is run including the employees of DEF, the ABC plan fails to satisfy the minimum coverage requirements of Section 410(b). The plan ceases to be tax qualified due to the failure to satisfy the minimum coverage requirements, i.e., as a result of a Demographic Failure.
4. What is an Employer Eligibility Failure?

The term “Employer Eligibility Failure” means, in the case of a qualified plan, the adoption of a Section 401(k) plan by a governmental entity, that is, by an ineligible employer. [Rev. Proc. 2008-50, Part III, Section 5.01(2)(d)]

5. Plans Other than Qualified Plans

The same basic definitions and terms apply when you are dealing with a plan that is eligible for special tax treatment but which is not a tax-qualified plan such as, for example, a SIMPLE IRA or a SEP.

For example, with respect to SIMPLE IRAs, such a plan can only be established by an “eligible employer.” An eligible employer means an employer which had no more than 100 employees who received at least $5,000 of compensation from the employer for the preceding year. [IRC Sections 408(p)(2)(C)(i), 401(k)(11)(D)] If, for purposes of determining whether the employer constitutes an “eligible employer,” the employer fails to include controlled group members, the maintenance of a SIMPLE IRA may ultimately constitute the maintenance by an ineligible employer if it turns out that the employer failed to qualify taken into consideration the other entity.

Example 5: The ABC Company maintains a SIMPLE IRA for its 80 employees, all of whom make over $5,000 a year. However, ABC also has a brother/sister partnership as a controlled group member that employs 40 employees, all of whom make over $5000 a year.

Because the two entities must be combined for controlled group purposes (the controlled group rules for employee benefit plan purposes are applied without regard to the unincorporated status of an entity). ABC is ineligible to maintain a SIMPLE after considering all employees in its controlled group.

A similar issue also arises if a controlled group member maintains another plan—a condition that renders any controlled group member ineligible to maintain a SIMPLE.

Example 6: The ABC Company maintains SIMPLE IRAs for its employees. Its brother/sister company, the DEF Company, a member of the same controlled group as ABC, maintains a Section 401(k) plan for its employees.

ABC is ineligible to maintain the SIMPLE.

Eligible for Self Correction? No.

Eligible for Possible Correction under VCP? Yes. ABC should stop making contributions to the SIMPLE and make application for correction with the IRS using its Voluntary Correction Program component of EPCRS, discussed later in this Outline. The goal would be for the IRS to bless prior years’ contributions thus allowing the amounts previously contributed to be retained in the SIMPLE as tax deferred amounts and distributed in accordance with the terms of the SIMPLE. However, no future contributions could be made.

If VCP Correction is Not Sought? If relief is not sought and granted from the IRS under VCP with respect to the prior contributions, ABC would be forced to undue all prior contributions and return the prior salary deferral contributions to the employees (and related earnings).
According to the IRS, where relief is not sought, (or granted) under VCP, for previously made ineligible contributions, those amounts, with applicable earnings, should be removed from the SIMPLE. The returned amounts should be reported on Form 1099-R as a taxable distribution that is not eligible for rollover.

Employer contributions (and related earnings) should be returned to the employer and reported on Form 1099-R issued to the participant indicating the taxable amount as zero. In addition, since no contributions could have been made to the SIMPLE IRA, the contributions are excess contributions that are subject to excise tax.

For each year that there are excess contributions in the SIMPLE, the employer is subject to the excise tax under Section 4972 (the 10% nondeductible excise tax) and is required to file Form 5330.

In addition, for each year that excess contributions are made to a participant’s SIMPLE IRA, the affected participant may be liable for excise tax under Section 4973 (the 6% excess contributions excise tax) which is to be reported on Form 5329.

[IRS 401(k) Fix-It Guide; http://www.irs.gov/retirement/sponsor/article/0,,id=181908,00.html]

C. Reviewing the Plan for Compliance

Plan sponsors and those helping them to maintain the tax-qualified status of their plans, should themselves review the plan annually to ensure compliance with the various laws that govern the plan as well as with the terms of the plan itself.

Such a review should include an assessment of the following:

Plan Document Issues

1. when was the last time the plan was amended?
   
   • if the plan is a qualified plan and has not been amended for two or more years, this may signal that there is a problem; while we cannot say that a plan will have to be amended every year, what we can say from history is that these plans have generally been required to be amended fairly frequently;

   • if the plan is a qualified plan on a prototype document, consider contacting the broker or financial advisor each year to ensure that no amendments have been misplaced by the client or not received;

   • if you are dealing with a client that often forgets about amendments received, consider having the financial advisor, broker, lawyer or whomever is providing the amendments, send copies of each amendment to you;
2. If you are performing the administration of the plan, make sure that the plan’s actual operation comports with what the plan document provides is to be done;

   If you are concerned that you are too close to the problem, consider having the plan and its operation reviewed by fresh eyes;

3. Are employees being admitted to the plan at the time provided for under the terms of the plan?
   - Is the plan sponsor a member of a controlled group—remember that for plan purposes, controlled groups include unincorporated entities;
   - If the plan is a SIMPLE IRA, does the business, and all controlled group members, in the aggregate have 100 or fewer employees who received at least $5000 in compensation for the preceding calendar year;
   - If the plan is a SEP, are all employees who are at least 21, employed by the sponsor for 3 of the immediately preceding 5 years and who received compensation of at least the minimum threshold amount of $450, increased for cost of living and currently $550, eligible to participate;
   - If you are excluding a class of employees, such as union members, does the plan actually contain this exclusion (this is particularly an issue with SIMPLEs);

4. If the plan is a SIMPLE, is it the only plan of the employer and of any controlled group member;

5. Is each employee’s contribution determined using the plan’s definition of compensation, correctly applying the plan’s formula, and subject to the applicable compensation limit?
   - If the plan is a qualified plan, is the compensation limited to the applicable maximum amount under Section 401(a)(17) (currently, $245,000)
   - If the plan is a qualified plan, are maximum allocations limited to the lesser of 100% of compensation or $49,000 for 2010;
   - If a Section 401(k) plan, are maximum elective contributions limited to $16,500 for calendar year 2010;
   - If a SIMPLE, maximum elective contributions cannot exceed $11,500 for 2010;
6. Are the correct vesting rules applied to the contributions?

- In the case of a qualified plan, while all employee contributions (including employee elective deferrals, i.e., Section 401(k) contributions) must be immediately and fully vested, employer contributions under a traditional Section 401(k) plan (that is, not a safe harbor plan) may be subject to a vesting schedule and must vest in accordance with that vesting schedule as set forth in the plan;

- If the plan is a SEP or SIMPLE IRA, are all contributions being treated as immediately vested and nonforfeitable;

7. Have elective deferrals been deposited timely?

- In a Section 401(k) plan, elective deferrals must be deposited as soon as they can be reasonably segregated from the employer’s general assets—this means days after the payroll—the DOL has issued a safe harbor for small plans (that is, plans with fewer than 100 participants) of up to the 7th business day following withholding;

- In the case of a SIMPLE IRA, employee contributions must be deposited in the IRA as of the earliest date on which such contributions can reasonably be segregated from the employer's general assets but in no event later than the 30th calendar day following the month in which the participant contribution amounts would otherwise have been payable to the participant in cash—note, however, the DOL states that the same general rule applies to employee contributions to a SIMPLE as applies to a 401(k) contribution and the 7th business day rule will also apply equally as a safe harbor with respect to a SIMPLE IRA.

8. Miscellaneous issues

- If a SEP or a qualified plan, is the plan top heavy, and if so, has each non-key employee received a minimum top heavy contribution of 3%?

- If the plan is a SIMPLE IRA, have all eligible employees been notified of their right to elect salary reduction or modify a prior salary reduction agreement before November 2;

- If the plan is a SIMPLE IRA, are employees allowed to terminate their salary reduction election at any time.
III. Fixing What’s Wrong

A. Self Correcting Certain Failures

1. What failures can you Self Correct?

Some qualification failures can be corrected by the plan sponsor without any involvement of the IRS. Where a plan failure can be self corrected within the meaning of IRS rules, the result is that the plan is considered requalified with all of the attendant tax benefits restored. Self correction does not involve any notification to or filing with the IRS nor does it require the payment of any fee or sanction amount. As such, where a failure can be self corrected, it is highly desirable.

However, not all plan failures can be self corrected. The IRS’ position is that only Operational Failures can be self corrected. This means, for example, if the plan has lost its tax-qualified status because it was not timely amended (i.e., a Plan Document Failure), the plan cannot self correct that failure and thus, requalify the plan. [Rev. Proc. 2008-50, Part IV, Section 7]

Notwithstanding the ability to self correct Operational Failures, certain failures, although qualifying as Operational Failures, are, nevertheless, prohibited from being self corrected. Operational Failures that cannot be self corrected include:

1. Egregious Operational Failures--for example, if an employer has consistently and improperly covered only highly compensated employees or if a contribution to a defined contribution plan for a highly compensated individual is several times greater than the dollar limit set forth in Section 415, or if the plan provides more favorable benefits for an owner of the employer based on a purported collective bargaining agreement where there has in fact been no good faith bargaining between bona fide employee representatives and the employer, all would be considered egregious and therefore not eligible for self correction.

2. Operational Failures Related to the diversion or misuse of plan assets. [Rev. Proc. 2008-507, Part II, Section 4.11, 4.12]

3. Abusive or Tax Avoidance Arrangements--in addition, you cannot self correct failures that arise under “abusive tax avoidance arrangements.” Specifically, if either the plan or the plan sponsor has been a party to an abusive tax avoidance transaction, you cannot self correct any Operational Failure that is directly or indirectly related to the abusive transaction. An abusive tax avoidance transaction generally means, for this purpose, any listed transaction under Treas. Reg. §1.6011-4(b)(2) and any other transaction identified as an abusive transaction in the IRS website entitled “EP Abusive Tax Transactions.”

Moreover, the IRS mandates the conditions under which a plan can self correct and the rules that must be abided in determining what constitutes an adequate method of correcting a failure.

2. Overriding Principles Governing Correction Method Used

Even if an Operational Failure can be self corrected, the plan sponsor is not free to correct the failure by whatever means it deems appropriate. Rather, the IRS mandates certain basic overriding correction
principles that apply to correction of any failures whether they are self corrected or corrected under one of the IRS correction programs that do necessitate IRS involvement (the Voluntary Correction Program and the Audit CAP Program discussed below).

It is necessary to adhere to these overriding correction principles in order that the IRS will recognize a plan’s method of correction as an appropriate one and therefore recognize the failure as truly corrected.

These overriding correction principles include the following:

(1) Correction requires full and complete correction for all taxable years, without regard to whether the statute of limitations is otherwise closed with respect to a plan year.

(2) Correction requires full correction with respect to all participants and beneficiaries. Thus, correction must be made not only with respect to active participants, but with affected former participants as well as beneficiaries. This means that the plan, participants (including former participants), as well as beneficiaries generally must be placed in the position and restored all of the benefits and rights they would have had absent the defect.

(3) The method of correction should be one that generally keeps plan assets in the plan, except to the extent that the Internal Revenue Code (the Code), regulations, or other guidance of general applicability provide for correction by distribution or return of assets to the employer.

(4) To the extent possible, the correction method should resemble one already provided for in the Code, regulations, or the other official guidance.

(5) The correction method for failures relating to nondiscrimination should provide benefits for non-highly compensated employees. For example, in the case of a Section 401(k) plan that fails to satisfy the Average Deferral Percentage requirement of Section 401(k)(3), correction by the addition of qualified nonelective contributions on behalf of non-highly compensated employees is generally a preferred method of correction over a method that would require distribution of the excess to the highly compensated employees.

(6) The correction method should not violate another applicable specific qualification requirement including, for example, the nondiscrimination rules of Section 401(a)(4) and the prohibition on cutting back or reducing benefits already earned as set forth in Section 411(d)(6).

(7) Generally, where more than one correction method is available to correct a failure, the correction method should be applied consistently in correcting all similar failures for that plan year. A similar rule applies with respect to the earnings adjustment method used.

(8) Where corrective allocations are required to a defined contribution plan, the allocation should be based upon the terms of the plan and other applicable information at the time of the failure (including the compensation that would have been used under the plan for the period with respect to which a corrective allocation is being made) and should be adjusted for earnings (including losses) and forfeitures that would have applied. However, a corrective allocation need not be adjusted for losses. A corrective allocation attributable to an error in a prior limitation year will not be considered an annual addition with
respect to the participant for the limitation year in which the correction is made, but will be considered an annual addition with respect to the participant for the limitation year in which the correction allocation relates. However, the normal deduction rules apply. Corrective allocations should come only from employer contributions (including forfeitures if the plan permits the use of forfeitures to reduce employer contributions).

(9) In the case of a corrective distribution from a defined benefit plan, the distribution should be increased to take into account the delayed payment, consistent with the plan’s actuarial adjustments.


3. Practices and Procedures Requirement—Applicable to Any Attempt to Self Correct

In addition to the requirement that the defects to be corrected come within the definition of Operational Failures, as a precondition to being able to self correct an Operational Failure, the plan sponsor or administrator of the plan must have established Practices and Procedures (formal or informal) reasonably designed to promote and facilitate overall compliance with the qualification requirements. A plan document alone will not constitute evidence of established procedures. In order for a plan sponsor or administrator to use self correction, these established procedures must have been in place and routinely followed, and an Operational Failure must have occurred either through an oversight or mistake in applying them, or because of an inadequacy in the procedures although the procedures in place were reasonable.

4. Beyond Practices and Procedures, Two Separate Tracks for Qualified Plans to Self Correct

If a plan has the requisite Practices and Procedures and all of the failures to be corrected fall within the definition of Operational Failures (and do not fall within those failures that cannot be self corrected as described above), there are two different possible alternatives available to qualified plans depending upon whether the Operational Failure(s) are in the aggregate, Significant or Insignificant.

Note, while much of the rules governing self correction apply similarly to SEPs and SIMPLE IRAs, only qualified plans have these two track options. SEPs and SIMPLEs can only self correct Operational Failures which are in the aggregate, Insignificant. [Rev. Proc. 2008-50, Part IV, Section 7]

In the case of a qualified plan, if the Operational Failure(s) are, in the aggregate, Significant, the plan has a limited window of time to self correct and, in addition, the plan must satisfy an additional eligibility requirement to be able to self correct.

A. Self Correction of Significant Operational Failures—Qualified Plans

1. Additional Eligibility Requirements

In addition to the need to satisfy the basic eligibility requirements that are preconditions to being able to self correct at all, (that is, that the defects to be corrected fall within the definition of Operational Failures and the need to satisfy the requirement to have established Practices and Procedures), a qualified plan will only be eligible to self correct Significant Operational Failures if, in addition, the plan has a current Favorable Determination Letter. [Rev. Proc. 2008-50, Part II, Section 4.03]
The definition of Favorable Determination Letter is broad enough to encompass opinion and notification letters in the case of adopters of master or prototype plans. However, generally, the definition will require a current letter and the definition is to be updated from time to time as the need requires in order to reflect changes in the governing laws.

2. Special Time Restrictions—Limited Window to Self Correct Significant Failures

In order to self correct Significant Operational Failures, the correction must 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, Section 9.02]

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.

3. 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 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 percent of all participants affected by the Operational Failure, and (b) thereafter, the plan sponsor completes correction of the defect with respect to the remaining affected participants in a diligent manner.


**Example 7:** Plan: a profit sharing plan.

Failure: the plan discovers in 2009 that for the plan year/calendar year ending 2007, it incorrectly calculated distributions to 12 participants.

Failure determined to be Significant by plan: the plan’s attorney has determined that the failures are Significant

Deadline for Completion: Because the failures are not determined to be Insignificant, this means that correction must be fully completed by the last day of the correction period, that is, by the last day of the second plan year following the plan year in which the failure occurred. This means that full correction must be completed by December 31, 2009.
Steps Taken: in May, 2009, the plan begins correcting this failure and completes the payment of the under payment amounts to 10 of the 12 participants.

Under Examination: after completing full correction for 10 of the 12 participants, the plan is then notified of an upcoming plan audit which begins in June, 2009.

The plan did not complete the corrections before the audit or before being notified of the upcoming audit. Normally, the audit would end the ability of the plan to self correct failures that it has determined are Significant.

Substantially Completed: however, because the plan has substantially completed the corrections before the audit, (i.e., during the correction period, correction is completed with respect to at least 65 percent of all participants affected by the Operational Failure, (here, 10 of the 12), the plan can continue to self correct the failure notwithstanding the above provided that the plan sponsor completes correction of the failure with respect to the remaining affected participants in a diligent manner.

4. Extension of Correction Period

There are other exceptions that may have the effect of extending the correction period.

First, in the case of a failure to satisfy the requirements of Section 401(k)(3), 401(m)(2) or 401(m)(9), the correction period does not end until the last day of the second plan year following the plan year that includes the last day of the additional period for correction permitted under the Code with respect to those sections. [Rev. Proc. 2008-50 Part IV, Section 9.02(1)]

Second, an extended correction period may be available where the failures arise solely with respect to Transferred Assets. Specifically, in the case of an Operational Failure that relates only to Transferred Assets, or to a plan assumed in connection with a corporate merger, acquisition or similar employer transaction, the correction period will not end until the last day of the first plan year that begins after the corporate merger, acquisition, or other similar employer transaction between the plan sponsor and the sponsor of the transferor plan or the prior sponsor of the assumed plan. [Rev. Proc. 2008-50, Part IV, Section 9.02(2)]

B. Self Correction of Insignificant Operational Failures—Available for Qualified Plans, SEPs and SIMPLE IRAs

1. No Favorable Determination Letter Required

A plan does not need a favorable determination or opinion letter in order to be eligible to self correct failures that are Insignificant. Thus, provided the plan otherwise satisfies the basic eligibility requirements for self correction, the plan sponsor and/or plan fiduciaries can elect to correct defects at any time provided the plan satisfies the Practices and Procedures requirements, failures are Operational Failures and are "Insignificant".
2. Correction Period is Unlimited—Even if Failures Discovered on Audit

The single most important feature of the self correction of failures deemed Insignificant is that these failures can be corrected at any time even if the plan or plan sponsor is under examination and even if the Insignificant Operational Failures are discovered by an agent on examination. [Rev. Proc. 2008-50, Part IV, Section 8.01]

3. Determining Whether Operational Failures are Insignificant

In determining whether an Operational Failure or multiple Operational Failures are Insignificant, the following factors are to be considered although the Revenue Procedure makes it clear that this list does not purport to include all the factors that should be considered:

1. whether other failures occurred during the period being examined (for this purpose, a failure is not considered to have occurred more than once merely because more than one participant is affected by the failure);

2. the percentage of plan assets and contributions involved in the failure;

3. the number of years the failure occurred;

4. the number of participants affected relative to the total number of participants in the plan;

5. the number of participants affected as a result of the failure relative to the number of participants who could have been affected by the failure;

6. whether the correction was made within a reasonable time after discovery of the failure; and

7. the reason for the failure (for example, data errors, such as errors in the transcription of data, the transposition of numbers, or minor arithmetic errors).

In the case of a plan with more than one Operational Failure in a single year, or Operational Failures that occur in more than one year, the Operational Failures are eligible for self correction only if all of the Operational Failures are Insignificant in the aggregate. Operational Failures that have been self corrected which were Significant Failures or corrected under the IRS’ Voluntary Correction Program, discussed below, are not taken into account for purposes of determining if Operational Failures are Insignificant in the aggregate. [Rev. Proc. 2008-50, Part IV, Section 8.02, 8.03]

No single factor is determinative. Moreover, factors 2, 4 and 5 are not to be interpreted in such a way as to exclude small plans from treating failures as Insignificant. [Rev. Proc. 2008-50, Part IV, Section 8.02]

This list does not purport to be an exclusive list of those factors that will or should be considered. Further, according to the Revenue Procedure, no one single factor is determinative.
Example 8: Plan: a profit sharing plan

Failure: in 2005, the benefits of 50 employees of the 250 participants were limited by Section 415(c); however, on audit in 2008, the Service discovered that during the 2005 limitation year, the annual additions allocated to the accounts of 3 of these employees exceeded the maximum limitations under Section 415(c).

Employer Contribution for 2005: $3.5 million

Amount attributable to failure: $4,550

Other violations? No

Insignificant? Yes, because the number of participants affected by the failure relative to the total number of participants that could have been affected by the failure, and the monetary amount of the failure relative to the total employer contribution to the plan for the 2005 plan year are considered to be insignificant.

Result: the Section 415(c) violation occurred in 2005 would be eligible for self correction under the Insignificant Failures component. [Rev. Proc. 2008-27, Part IV, Section 8.04, Example 1]

Example 9: Same facts as Example 8 except that the violation of Section 415 occurred during 2005 and 2007 limitation years.

In addition, the 3 participants affected by the Section 415 violation were not identical each year.

Result: the fact that the Section 415 failures occurred during more than one limitation year did not cause the failures to be significant; accordingly, the failures are still eligible for correction under the Insignificant Failures component of self correction. [Rev. Proc. 2008-50, Part IV, Section 8.04, Example 2]

Example 10: Assume the same facts as in Example 8 except that the annual additions of 18 of the 50 employees whose benefits were limited by Section 415(c) nevertheless exceeded the maximum limitations under Section 415(c) during the 2005 limitation year, and the amount of the excesses ranged from $1,000 to $9,000 and totaled $150,000.

Result: Significant. under these facts, taking into account the number of participants affected by the failure relative to the total number of participants who could have been affected by the failure for the 2005 limitation year (and the monetary amount of the failure relative to the total employer contribution), the failure is Significant. Accordingly, the Section 415(c) failure in Plan A that occurred in 2005 is ineligible for correction under the Insignificant Failures component of the self correction program. [Rev. Proc. 2008-50, Part IV, Section 8.04, Example 3]
Example 11: Employer J maintains Plan C, a money purchase pension plan established in 1992. The formula provides for an employer contribution equal to 10% of compensation. During its examination of the plan for the 2005 plan year, the Service discovered that the employee responsible for entering data into the employer’s computer made minor arithmetical errors in transcribing the compensation data with respect to 6 of the plan’s 40 participants resulting in excess allocations to those 6 participants’ accounts. Under these facts, the number of participants affected by the failure relative to the number of participants that could have been affected is Insignificant, and the failure is due to minor data errors. Thus, the failure occurring in 2005 would be Insignificant and therefore eligible for correction under the Insignificant Operational Failures component of self correction. [Rev. Proc. 2008-50, Part IV, Section 8.04, Example 4]

C. Reformation Self Correction--Correction by Retroactive Amendment

Generally, correction of Operational Failures means putting all participants and the plan in the position each would have been in absent the failure. This effectively means that correction requires reforming the plan’s actual operation to the terms of the plan.

However, in a limited number of cases involving Operational Failures, correction can instead be accomplished by reforming the terms of the plan to comply with the plan’s actual, albeit incorrect, operation. [Rev. Proc. 2008-50, Part II, Section 4.05(2)]

Self correction by reformation is only available with respect to the correction of the following failures and still requires that the plan satisfy the basic requirements for being eligible to self correct. Moreover, if a plan self corrects using these procedures, it may only self correct by adopting the specific correction method so identified. Further, the retroactive amendment must comply with the requirements of Sections 401(a), 401(a)(4), 410(b), and 411(d)(6). The types of defects and the required method of correction are as follows:

1. Hardship distribution and Loan failures: the operational failure of making hardship distributions or granting a loan to employees under a plan that does not provide for hardship distributions, or a loan, as applicable.

A correction may be made by amending the plan retroactively to provide for the hardship distribution or loan as applicable provided in the amendment that satisfies Section 401(a) and the plan, as amended, would have satisfied the qualification requirements of Section 401(a), including the requirements applicable to hardship distributions under Section 401(k), if applicable, had the amendment been adopted when the distributions were first made available;

2. 401(a)(17) failures: the allocation of contributions or forfeitures under a defined contribution plan for a plan year on a basis of compensation in excess of the limit under Section 401(a)(17).

In the case of a defined contribution plan only, the employer may correct by contributing an additional amount on behalf of each of the other employees (excluding each employee for whom there was a Section 401(a)(17) failure) who received an allocation for the year of the failure, amending the plan (as necessary) to provide for the additional allocation, adjusted for earnings. The amount contributed for an employee is equal to the employee’s
plan compensation for the year of the failure multiplied by a fraction, the numerator of which is the improperly allocated amount made on behalf of the employee with the largest improperly allocated amount, and the denominator of which is the limit under Section 401(a)(17) applicable to the year of the failure. The resulting additional amount for each of the other employees is adjusted for earnings;

3. Early inclusion of otherwise eligible employee failure: the operational failure of including an otherwise eligible employee in the plan who either has not completed the plan's minimum age or service requirements or has completed the plan's minimum age and service requirements but became a participant on a date earlier than the applicable entry date.

The plan is amended to retroactively change the eligibility or entry date provisions to provide for the inclusion of the ineligible employee to reflect the plan's actual operations. The amendment may change the eligibility or entry date provisions with respect to only those ineligible employees that were wrongly included, and only to those ineligible employees, provided: (1) the amendment satisfies Section 401(a) at the time it is adopted, (2) the amendment would have satisfied Section 401(a) had the amendment been adopted at the earlier time when it is effective, and (3) the employees affected by the amendment are predominately non-highly compensated employees.

[Rev. Proc. 2008-50, Appendix B, 2.07]

D. Self Correcting some Common Failures

1. Reformation Self Correction to correct Early Entry

Example 12:

Factual Information

Type of Plan: 401(k)
Plan Year: Calendar Year
Relevant Plan Terms: Entry on July 1 or January 1 following 1 Year of Service
Relevant Information: Plan has total of 22 participants, 2 of which are Highly Compensated, (HCE).
Plan has assets of $500,000 including contribution for 2008
Assets attributable to the Failure: $2000 participant contribution + $1000 matching contribution
Total Contribution to the Plan for 2008 was $80,000
Failure: Of 2 Non-Highly Compensated Employees (NHCE) eligible to enter for 2008, 1 was allowed to enter too early.
**Eligible for Self Correction?**

Is the Failure Operational: Yes, failure to follow plan terms

Practices and Procedures: Yes, plan uses an outside CPA to administer the plan; CPA sends over Census Form requesting relevant census information that should lead to correct entry.

**What Type of Self Correction?**

Is Failure Significant or Insignificant: Insignificant—Failure affects $3,000/$500,000 or .006

- Failure affects 1 participant out of total of 22 participants or .045
- Only damaging statistic is that it affects ½ of participants that could be affected

**How to Correct?**

This is one of the limited failures that can be corrected by Reformation—that is, amending the plan retroactively to actually provide for entry at the time that the employee was incorrectly admitted.

Moreover, since those affected are primarily (or here, exclusively non-highly compensated—NHCE), the amendment would not have violated the requirements of Section 401(a), the retroactive amendment can be limited solely to that one employee.

2. **Self Correcting Exclusion of Eligible Employee from 401(k) Deferrals**

a. **Special Correction Rules for Missed Deferrals and other Employee Contributions**

When it comes to correcting failures resulting from the failure to properly handle employee contributions, such as the failure to allow employees to make elective deferral contributions when first eligible, the IRS recognizes that it would not be entirely fair to require the employer to make up the entire missed contribution. This is because, while the employee lost the value of the deferral, he/she still had the value of the actual funds. As such, the correction principles when dealing with those types of failures allow the employer to instead make up for the value of “missed opportunity.” In a bid to do rough justice, IRS rules determine that the value of the “lost opportunity” to the employee will be equal to 50% of the pre-tax deferrals, for safe harbor 401(k) plans, the deferral percentage is assumed to be 3% (or higher, if the plan provides for at least 100% match for higher level of deferral) and for after-tax employee contributions, the value of the “lost opportunity” will be equal to 40% of the after-tax employee contributions that would have been made if the employee had been timely included in the plan.

For an employee excluded from a plan that provides for matching contributions, the corrective contribution for the excluded employee is equal to the matching contribution that the employee would have received had the employee made a deferral equal to the missed deferral. (Note: similar analogy applies if the plan matches after-tax employee contributions).
It should be noted, however, that the principle of determining corrective contributions based on “lost opportunity,” with respect to elective contributions solely applies to the excluded employee failure. It cannot be used to correct other qualification failures.

Example—EE Not Allowed To Participate in 401(k) Timely

Example 13: A Section 401(k) plan provides for matching contributions for eligible employees equal to 100% of elective deferrals that do not exceed 3% of an employee's compensation.

The plan allows employees to make after-tax employee contributions up to a maximum of the lesser of 2% of compensation or $1,000.

The after-tax employee contributions are not matched.

The plan provides that employees who complete one year of service are eligible to participate in the plan on the next designated entry dates which are January 1, and July 1.

In 2007, it is discovered that Chris, a non-highly compensated employee with compensation of $30,000, was excluded from the plan for the 2006 plan year even though she satisfied the plan's eligibility requirements as of January 1, 2006.

For the 2006 plan year, the relevant employee and contribution information is as follows:

<table>
<thead>
<tr>
<th>Compensation</th>
<th>Elective deferral</th>
<th>Match</th>
<th>After-tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>HCE 1</td>
<td>$200,000</td>
<td>$6,000</td>
<td>$6,000</td>
</tr>
<tr>
<td>HCE 2</td>
<td>$150,000</td>
<td>$12,000</td>
<td>$4,500</td>
</tr>
<tr>
<td>NHCE1</td>
<td>$ 80,000</td>
<td>$12,000</td>
<td>$2,400</td>
</tr>
<tr>
<td>NHCE2</td>
<td>$50,000</td>
<td>$  500</td>
<td>$  500</td>
</tr>
</tbody>
</table>

**HCEs:**
- ADP: 5.5%
- ACP: 3.33%
- ACP: attributable to matching contributions-3%
- ACP: attributable to after-tax employee contributions-0.33%

**NHCEs:**
- ADP: 8%
- ACP: 2.63%
- ACP: attributable to matching contributions-2%
- ACP: attributable to after-tax employee contributions-0.63%
Assume that this is the only failure applicable for the period at issue and that the plan satisfies the requisite practices and procedures requirement and the failure otherwise qualifies for self correction.

The employer would correct by making a qualified nonelective contribution (QNEC, meaning an employer contribution that substitutes for the missed employee elective contribution and, aside from not being eligible for hardship withdrawals, is subject to the same rules that apply to employee elective contributions) on behalf of Chris for the 2006 plan year equal to the lost opportunity amount to reflect the fact that Chris was eligible to participate, but was not provided the opportunity to do so.

This missed opportunity is 50% of Chris’ deemed missed deferral. This contribution, which must be fully vested and otherwise treated as an elective deferral for most purposes, must be adjusted for earnings. The missed deferral for Chris is determined by using the ADP for NHCEs for 2006 and multiplying that percentage by Chris’ compensation for 2006.

The actual Missed Deferral

Accordingly, the missed deferral for Chris on account of the employee’s improper exclusion from the plan is $2,400 (8% × $30,000).

Missed Deferral Opportunity

Thus, the missed deferral opportunity is $1,200 (i.e., 50% × $2,400).

Contribution Required to make up for Missed Elective Opportunity is only $1200 adjusted for earnings

Thus, the required corrective contribution for the failure to provide Chris with the opportunity to make elective deferrals to the plan is $1,200 (plus earnings).

Full Match Required

Matching contributions: Chris should have been eligible for, but did not receive, an allocation of employer matching contributions because Chris was not provided the opportunity to make elective deferrals in 2006. Thus, the employer must make a qualified nonelective contribution to the plan on behalf of Chris that is equal to the matching contribution Chris would have received had the missed deferral been made. The QNEC is adjusted for earnings. Under the terms of the plan, if Chris had made an elective deferral of $2,400 or 8% of compensation ($30,000), the employee would have been entitled to a matching contribution equal to 100% of first 3% of Chris’ compensation ($30,000) or $900. Accordingly, the contribution required to replace the missed employer matching contribution is $900 (plus earnings).

Substitute for Missed After-Tax Contribution

After-tax employee contributions: Chris was eligible to, but was not provided with the opportunity to, elect and make after-tax employee contributions in 2006. The employer must make a qualified nonelective contribution to the plan equal to the missed opportunity for making after-tax employee contributions for Chris, which is 40% of Chris’ missed after-tax employee
contribution. The QNEC is adjusted for earnings. The missed after-tax employee contribution for Employee V is estimated by using the ACP for NHCEs (to the extent that the ACP is attributable to after-tax employee contributions) for 2006 and multiplying that percentage by Chris’ compensation for 2006. Accordingly, the missed after-tax employee contribution for Chris, on account of the employee’s improper exclusion from the plan is $189 (0.63% × $30,000). The missed opportunity to make after-tax employee contributions to the plan is $76 (40% × $189). Thus, the required corrective contribution for the failure to provide Chris V with the opportunity to make the $189 after-tax employee contribution to the plan is $76 (plus earnings). The total required corrective QNEC, before adjustments for earnings, on behalf of Chris is $2,176 ($1,200 for the missed deferral opportunity plus $900 for the missed matching contribution plus $76 for the missed opportunity to make after-tax employee contributions). The required corrective QNEC is further adjusted for earnings.

Same Basic Principles Would be Applied to SARSEP or SIMPLE

If, instead of occurring in a Section 401(k) plan, the same type of failure had occurred in a SARSEP or a SIMPLE, you would correct in the same manner.

3. Self Correcting ADP and ACP Failures

Provided the plan otherwise qualifies to self correct, ADP and ACP failures can be eligible for correction at a lower cost than what would otherwise be the case. This is because the IRS has sanctioned a correction method known as the One-to-One Correction method for the correction of nondiscrimination test failures that are not corrected in a timely fashion.

The essence of this correction method is to determine the excess amounts attributable to the plan’s highly compensated employees, distribute those amounts to the affected HCEs, adjusted for earnings, and at the same time, the plan sponsor contributes that same amount to the plan.

Example—Correcting ADP and ACP Nondiscrimination Failures

Example 14: The ABC company maintains a Section 401(k) plan.

The plan does not provide for matching contributions or after-tax employee contributions. In 2007, it was discovered that the ADP test for 2005 was not performed correctly. When the ADP test was performed correctly, the test was not satisfied for 2005.

For 2005, the ADP for highly compensated employees was 9% and the ADP for nonhighly compensated employees was 4%.

Accordingly, the ADP for highly compensated employees exceeded the ADP for nonhighly compensated employees by more than two percentage points (in violation of § 401(k)(3)).

HCEs

There were 2 eligible HCEs under the plan during 2005, Pat and Lee.

Pat made elective deferrals of $10,000, which is equal to 10% of Pat’s compensation of $100,000 for 2005.
Lee made elective deferrals of $9,500, which is equal to 8% of Lee’s compensation of $118,750 for 2005.

Assume that this is the sole failure applicable to the plan and that the plan otherwise satisfies the requirements for self correction.

**Correction Using One-to-One Correction Method**

On June 30, 2007, the employer uses the One-to-One correction method to correct the failure to satisfy the ADP test for 2005. Accordingly, the employer calculates the dollar amount of the excess contributions for the two highly compensated employees in the manner described in § 401(k)(8)(B).

The amount of the excess contribution for Pat is $4,000 (4% of $100,000) and the amount of the excess contribution for Lee is $2,375 (2% of $118,750), or a total of $6,375.

In accordance with § 401(k)(8)(C), $6,375, the excess contribution amount, is assigned $3,437.50 to Pat and $2,937.50 to Lee. It is determined that the earnings on the assigned amounts through June 30, 2007 are $687 and $587 for Pat and Lee, respectively. The assigned amounts and the earnings are distributed to Pat and Lee. Therefore, Pat receives $4,124.50 ($3,437.50 + $687) and Lee receives $3,524.50 ($2,937.50 + $587).

In addition, on the same date, the employer makes a corrective contribution to the § 401(k) plan equal to $7,649 (the sum of the $4,124.50 distributed to Pat and the $3,524.50 distributed to Lee). The corrective contribution is allocated to the account balances of eligible non-highly compensated employees for 2005, pro rata based on their compensation for 2005 (subject to § 415 for 2005).

4. **Correcting Top Heavy Contribution Failures**

In a defined contribution plan, the permitted correction method is to properly contribute and allocate the required top-heavy minimums to the plan in the manner provided for in the plan on behalf of the non-key employees (and any other employees required to receive top-heavy allocations under the plan). In a defined benefit plan, the minimum required benefit must be accrued in the manner provided in the plan.

**Example 15:** The ABC company maintains a Section 401(k) plan that satisfied all of the nondiscrimination rules that applied to before-tax contributions and matching contributions.

**Failure:** the plan was top heavy for the calendar year/plan years that began in 2007 and 2008 but the employer’s contributions on behalf of its 2 non-key employees failed to satisfy the top heavy minimum contribution requirements.

**Self Correction?** Yes, provided the plan meets all of the eligibility requirements for self correction, this is an operational problem that could be self corrected.

**Deadline for Correction:** if the failures are determined to be Significant, the employer would be required to make the corrective contribution for the 2007 plan year by the end of 2009 and the 2008 corrective contribution by December 31, 2010.
If the company concludes that the failures are Insignificant in the aggregate (taking into consideration all failures for the years at issue), the company can correct beyond the 2 year window available to correcting Insignificant failures.

5. **Self Correcting Exclusion from SIMPLE IRA (Assuming that Failure is Insignificant)**

**Example 16:** Chris satisfied the requirements of her employer’s SIMPLE IRA. However, Chris was overlooked and not allowed to participate.

During the period at issue, Chris had compensation of $10,000.

The SIMPLE provides for an employer matching contribution not to exceed 3% of the employee’s compensation.

Chris’ Missed Salary Deferral is actually $300, that is, 3% of $10,000.

The Missed Deferral Opportunity required to be contributed by the company to make up for Chris’ missed salary deferral is however, 50% of $300 or $150 plus earnings. (this missed deferral opportunity recognizes that although Chris did not get the benefits of deferring $300, she nevertheless still actually received the full $300 in her wages currently. Therefore, what she actually lost was the opportunity for deferral which the IRS has approximated to be worth 50% of the missed deferral)

Employer Match required to be contributed is, however, the full match that Chris would have received had she made the full salary deferral contribution of $300, plus earnings. Thus, the employer match required is $300 plus earnings.

Total Corrective Contribution=$450 plus earnings

6. **Exclusion under SEP**

**Example:** Pat owns the ABC Manufacturing Company as well as the DEF Grocery. ABC employs 25 employees while the DEF company has a total of 40 employees.

Pat establishes a SEP for the employees of the ABC Manufacturing Company only.

As members of the same controlled group, the employees of DEF would be considered eligible employees and their exclusion would be treated as a failure.

**Eligible for Self Correction?** No, the IRS would not view the wholesale exclusion of 40 out of a total of 65 employees as Insignificant.

As such, voluntary correction could only be accomplished by making a submission under the VCP component of EPCRS.
E. Voluntary Correction through the IRS

1. Background

Until relatively recently, where a plan failed to adhere to all of the rules governing tax qualification, the sole official sanction available to the IRS was actual disqualification of the plan. True disqualification, however, not only resulted in harm to the plan sponsor in the form of the loss of the deduction for plan contributions taken for all open years, but injury to non-highly compensated employees as well in the form of income inclusion. In view of the result, as well as the inherent complexities of the qualification rules, actual disqualification often seemed a draconian response to many relatively minor violations. Recognizing this problem, where errors in plan operation did not appear to be deliberate or egregious, often the examining agents would, in practice, allow retroactive correction where the errors did not appear deliberate and the intent did not appear to be to benefit highly compensated employees.

However, this practical response resulted in its own set of problems not the least of which was the lack of uniform results from plans to plans and IRS offices to offices.

In response to these concerns, the Service has established the Employee Plans Compliance Resolution System (EPCRS) formally implementing a uniform correction program which consists of the following underlying programs:

1. the Self-Correction Program which we have just previously discussed and which actually necessitates no IRS involvement;

2. the Voluntary Correction Program (VCP) and

3. the Audit Closing Agreement Program (Audit CAP)—the program that the IRS will force on plans as a last resort to avoid disqualification where failures are discovered on audit of the plan by the IRS.

If your plan has failures that either cannot be corrected using self correction or which can, but for which the plan sponsor wants the certainty that comes with IRS involvement and approval or wants the flexibility to propose a correction method other than one sanctioned under the rules governing self correction, the Voluntary Correction Program (VCP) is the program that is available.

Unlike self correction which can only be used to correct Operational Failures, VCP can be used to correct all four types of Qualification Failures, i.e., Plan Document Failures, Qualification Failures, Demographic Failures as well as Employer Eligibility Failures.

The same overriding Correction Principles discussed in the context of self correction apply equally in the case of correction under VCP.
2. **Why Involve the IRS by submitting for approval under VCP?**

There are several reasons why a plan may wish to submit Qualification Failures to the IRS under the VCP program rather than trying to self correct.

a. **Broader Availability**

First, the failures may not be eligible for self correction. Remember that self correction is only available to correct those Qualification Failures that constitute Operational Failures. If the plan has other failures, for example, the failure to be timely amended for changes, that is, a Plan Document Failure, the plan has no choice but to attempt to correct under VCP.

Contrast that with VCP. VCP is eligible to correct all Qualification Failures including: Operational Failures, Plan Document Failures, Employer Eligibility Failures as well as plan Demographic Failures. [Rev. Proc. 2008-50, Part II, Section 4.01(2)]

b. **Broader Correction Options Potentially Available**

VCP provides a greater potential for use of reformation to correct failures. Specifically, a plan sponsor may, subject to the approval of the IRS, use VCP to correct Operational, Plan Document, or Demographic failures by use of a plan amendment to conform the terms of the plan to 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). [Rev. Proc. 2008-50, Part II, Section 4.05(1)] This could potentially result in significant savings to the plan sponsor in correcting plan failures.

Thus, even if the plan has solely Operational Failures that could be self corrected, the plan may nevertheless still prefer to correct under VCP, because:

1. **Certainty**—self correction may leave an air of uncertainty in that, if the failure corrected is not one for which specific guidance is contained in the Revenue Procedure as to how you correct, the plan will not be sure that it has made correction that will be acceptable to the IRS unless it is audited;

   Submission under VCP brings with it the review and approval by the IRS;

2. **Flexibility**—even if a failure can be self corrected, the rules as to how you correct are fairly rigid; if, for example, the cost of the approved method of self correction would be prohibited, VCP offers the possibility of negotiating with the IRS and having them approve a more creative or out of the box correction method;
Example 17: A money purchase pension plan of a not-for-profit entity that has been in effect since the 1960s has always been operated with the assumption that the Executive Director would not participate in the money purchase plan but rather would participate solely in a separate nonqualified deferred compensation arrangement. Unfortunately, the prototype plan document does not reflect his exclusion.

This is the plan’s sole failure and constitutes an Operational Failure stemming from the failure to follow the terms of the plan. However, self correction would require that the plan retroactively include the Executive Director and that the not-for-profit make up the missed contributions. This is because the essence of the correction principles requires that the correction method used be one that puts assets in the plan and, more importantly, conforms the plan’s operation to its terms. The few instances allowed under self correction to use reformation (that is, to retroactively amend the plan to conform to its actual operation) do not cover this situation.

However, by submitting under VCP with its broader flexibility of both failures and correction methods, the plan proposes to instead reform the plan’s terms to its actual operation. The plan submits information supporting the assertion that all parties understood and agreed that the plan would in fact exclude the Executive Director. The evidence includes an affidavit from the Executive Director and a copy of the nonqualified plan.

The IRS accepts the proposed correction and the plan is requalified without the payment of significant contributions to the plan from the not-for-profit that otherwise would have been required to be made to self correct.

c. Egregious Failures may be Corrected but not Misuse of Plan Assets

While VCP is available to correct egregious failures, it is not available to correct failures relating to the diversion or misuse of plan assets. [Rev. Proc. 2008-50, Part II, Section 4.11 and 4.12]

d. Correcting Terminated Plans

Terminated plans may use VCP to correct otherwise eligible failures without regard to whether the trust remains in existence. [Rev. Proc. 2008-50, Part II, Section 4.07]

e. Special Rule for 457(b) Arrangements

Submissions relating to Section 457(b) eligible governmental plans will be accepted by the IRS on a provisional basis outside of VCP but using similar standards. [Rev. Proc. 2008-50, Part II, Section 4.09]

3. Monetary Fee or Sanction

Submission under VCP requires that the plan submit an application disclosing the failures and other information and also pay a VCP user fee, which cannot be paid by the plan.
a. General Fee

The general VCP fee, including those using the John Doe (Anonymous—discussed below) submission procedure, is based upon the number of participants in the plan and is determined as follows:

<table>
<thead>
<tr>
<th>Number of Participants</th>
<th>Fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>20 or fewer</td>
<td>$750</td>
</tr>
<tr>
<td>21 to 50</td>
<td>$1,000</td>
</tr>
<tr>
<td>51 to 100</td>
<td>$2,500</td>
</tr>
<tr>
<td>101 to 500</td>
<td>$5,000</td>
</tr>
<tr>
<td>501 to 1000</td>
<td>$8,000</td>
</tr>
<tr>
<td>1001 to 5,000</td>
<td>$15,000</td>
</tr>
<tr>
<td>5001 to 10,000</td>
<td>$20,000</td>
</tr>
<tr>
<td>Over 10,000</td>
<td>$25,000</td>
</tr>
</tbody>
</table>


b. General Fee Structure for Nonamenders

Generally, the fee structure for nonamenders (that is, those plans that do not timely amend for legislative changes, including the good-faith amendment requirements for EGTRRA) is determined in accordance with the above. However, the applicable fee for VCP submissions is reduced by 50% for nonamenders that submit under VCP within a one year period following the expiration of the plan's remedial amendment period for complying with the change. [Rev. Proc. 2008-50, Part V, Section 12.03]

c. Special Fee for Failure to Adoption Interim or Optional Amendments

Nevertheless, if the only failure is the failure to timely adopt an interim amendments or an amendment to implement an optional law change is $375. [Rev. Proc. 2008-50, Part V, Section 12.03]

d. Special Fee for SEPs and SIMPLE IRAs

Generally, the compliance fee for a SEP or a SIMPLE IRA submission (including a John Doe submission) is $250. However, the IRS reserves the right to instead impose a higher fee similar to the schedule that would be applied in the case of a qualified plan or to impose the fee applicable to egregious or intentional failures discussed below. The IRS can also impose a higher fee where the correction is not similar to a correction for a similar qualification failure. [Rev. Proc. 2008-50, Part V, Section 12.05]
e. Special Fee for Required Minimum Distribution Failures

Under another special rule, where the submission involves the failure to satisfy the required minimum distribution requirements of Section 401(a)(9) for 50 or fewer participants, and that is the only failure, and the failure would result in the imposition of the excise tax under Section 4974, the compliance fee will be $500. [Rev. Proc. 2008-50, Part V, Section 12.02(2)]

f. Special Fee for Loan Failures

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)]

g. Enhanced Fee for Egregious or Intentional Failure

In the case of an egregious failure (for example, if an employer has consistently and improperly covered only highly compensated employees or if a contribution to a defined contribution plan for a highly compensated individual is several times greater than the dollar limit set forth in Section 415), or where the failure is not inadvertent, the compliance fee (for qualified plans, 403(b), SEPs and SIMPLE IRAs) is the greater of the fee that would otherwise normally be charged or an amount equal to a negotiated percentage of the amount of taxes that would be paid if the plan were actually disqualified, but with the percentage not to exceed 40 percent. [Rev. Proc. 2008-50, Part V, Section 12.06].

h. Fee Where Agreement Not Reached

If the IRS and the sponsor/administrator cannot reach agreement, the matter will be closed, the compliance fee will not be returned and the case may be referred for examination. However, in the case of an Anonymous submission that fails to reach resolution under VCP, the IRS will refund 50% of the applicable VCP fee. [Rev. Proc. 2008-50, Part V, Section 10.07(7)]

4. Effect of being Under Examination

Submissions can only be made under VCP if they are voluntary. This means that the examination of the plan or the impending examination of the plan cuts off the opportunity to submit the failures for correction under VCP.

Note, however, even if the plan or plan sponsor is under examination, Insignificant Operational failures may still be self corrected and, if correction has been substantially completed before the plan or plan sponsor is under examination, self correction of Significant Operational Failures may continue. [Rev. Proc. 2008-50, Part II, Section 4.02]

The term “Under Examination” means: (1) a plan that is under an Employee Plans examination (that is, an examination of Form 5500 or other Employee Plans examination), or (2) a plan sponsor that is under an Exempt Organizations examination (that is, an examination of a Form 990 series or other Exempt Organizations examination); or (3) a plan that it under investigation by the Criminal Investigation Division of the Internal Revenue Service.
A plan is also deemed to be “Under Examination” for this purpose if the plan sponsor or a representative has received a verbal or written notification from Employee Plans of an impending Employee Plans examination, or of an impending referral for an Employee Plans examination, and also includes any plan that has been under Employee Plans examination and is now in Appeals or litigation for issues raised in the Employee Plans examination. A plan is also considered to be Under Examination if it is aggregated for purposes of satisfying the nondiscrimination requirements of Section 401(a)(4), the minimum participation requirements of Section 401(a)(26), the minimum coverage requirements of Section 410(b) with a plan that is Under Examination. In addition, a plan is considered Under Examination with respect to a failure of a qualification requirement (other than those in the preceding sentence) if the plan is aggregated with another plan for purposes of satisfying that qualification requirement and that other plan is Under Examination.

A qualified plan will also be deemed to be “Under Examination” if the plan sponsor submits a determination letter application (Form 5300 series) and the agent notifies the plan sponsor or its representative of a possible Qualification Failure, whether or not the plan sponsor is officially notified of an examination. Further, if during the review process, the agent requests additional information that indicates the existence of a Qualification Failure not previously identified by the plan sponsor, the plan will be considered to be “Under Examination”. If, in such a case, the determination letter request under review is subsequently withdrawn, the plan is nevertheless considered to be under examination for purposes of eligibility under self correction and VCP with respect to those issues raised by the agent reviewing the determination letter application. The fact that the determination application was filed voluntarily will not mean that the failures discovered by the agent are eligible for VCP. Rather, it is only if the plan sponsor, or the representative, identifies the failures, in writing, to the reviewing agent before the agent recognizes the existence of the Qualification Failures and/or addresses the Qualification Failures in communications with the plan sponsor or the authorized representative, that the plan will be able to perfect a VCP submission as a result of a determination letter application.

A plan sponsor that is under an exempt organizations examination includes a plan sponsor that has received (or whose representative has received) verbal or written notification from Exempt Organizations of an impending Exempt Organizations examination or of an impending referral for an Exempt Organizations examination and also includes any plan sponsor that has been under an Exempt Organizations examination and is now in Appeals or in litigation for issues raised in an Exempt Organizations examination. [Rev. Proc. 2008-50, Part III, Section 5.07]

5. A Word About Audits and Self Correction

Remember, the fact that a plan is under audit does not foreclose all possibility of correction. If the plan has “substantially completed” the correction as discussed under the Self Correction of Significant failures prior to the start of the audit, the plan can complete correction.

In addition, and most importantly, if the plan can convince the agent that the failure(s) are, in the aggregate Insignificant, the plan can Self Correct the failures at any time even if the failures are discovered during the audit by the IRS agent. [see the discussion above regarding Self Correction]
6. General Submission Process

Essentially, under VCP, an application is completed which discloses the existence of the failures, how they occurred, and most importantly, ask the IRS to approve the proposed correction method or the correction method previously used to correct the failures.

The process currently takes 6-9 months to complete. Once agreement is reached, the IRS issues the plan a Compliance Statement that essentially reflects the requalification of the plan.

Except in unusual circumstances, a plan that has been properly submitted under VCP will not be examined while the submission is pending. [Rev. Proc. 2008-50, Part V, Section 10.04]

7. John Doe (Anonymous) Submissions

Sometimes the plan sponsor may be wary of disclosing its identity to the IRS unless and until agreement is reached on the proposed correction method. This may be particularly the case if the proposed correction method is viewed as being one that the IRS may not approve. The plan sponsor wants to avoid not reaching agreement and possibly triggering an examination of the plan. In such cases, the plan sponsor may prefer to use the John Doe, or Anonymous VCP submission process.

Generally, the same procedural requirements apply to a John Doe submission as any other submission made under VCP expect that identifying information is redacted until the IRS and the plan sponsor reach agreement. Once agreement is reached, the IRS will contact the plan representative in writing indicating the terms of the agreement. The plan sponsor will then have twenty-one calendar days from the date of the letter to identify the plan and plan sponsor. If the plan sponsor does not submit the identifying information within the twenty-one day time frame, the matter will be closed and the compliance fee will not be returned.

However, one potential drawback to use of this procedure is the lack of protection in the event of an audit. Until the identifying information is released to the IRS, a submission under the John Doe procedure does not preclude or impede an examination by the IRS. Thus, a plan submitted under the John Doe procedure that comes under an examination prior to the date the plan and plan sponsor identifying materials are received by the IRS will no longer be eligible for either anonymous submission procedure or the VCP in general.


8. VCGroup Submissions

An “Eligible Organization” may submit a VCP request for a group of plans for Operational and Plan Document failures. This procedure is available to allow master or prototype plan sponsors or administrative firms that discover a single defect that permeates, in the case of the former, the plan document, and in the case of the latter, the operation of a plan, may submit all such plans for correction subject to satisfaction of specific requirements. [Rev. Proc. 2008-50, Part V, Section 10.11]

An “Eligible Organization” means either a sponsor of a pre-approved plan such as a master or prototype, or an administrative firm that provides third-party administrative services to its clients. However, in order to be eligible to submit, the Eligible Organization must identify a failure resulting from a systematic error involving the Eligible Organization that affects at least 20 plans and that results in at least 20 plans
implementing the correction. If, before any time the Service issues the compliance statement, the number of plans falls below 20, the Eligible Organization must notify the Service that it is no longer eligible to make a Group Submission and the compliance fee may be retained. [Rev. Proc. 2008-50, Part V, Section 10.11(2)]

9. Sample Corrections under VCP

a. Failure to Implement Elective Contribution Election

The same basic principles discussed in dealing with improperly handled employee elective contributions in the context of self correction, applies equally in the case of correction under VCP. This means that the employer must contribute a QNEC to make up for the value of the missed opportunity, adjusted for earnings. For eligible employees who filed elections to make elective deferrals under the plan which the plan sponsor failed to implement on a timely basis, the plan sponsor must make a QNEC to the plan on behalf of the employee to replace the “missed deferral opportunity.” The missed deferral opportunity is equal to 50% of the employee’s “missed deferral.” The missed deferral is determined by multiplying the employee’s elected deferral percentage by the employee’s compensation. If the employee elected a dollar amount for an elective deferral, the missed deferral would be the specified dollar amount. The employee’s missed deferral amount is reduced further to the extent necessary to ensure that the missed deferral does not exceed applicable plan limits, including the annual deferral limit under § 402(g) for the calendar year in which the failure occurred.

Example 18--Failure to Implement Employee Election

Plan: a Section 401(k) plan.

Employer Match: the plan provides for matching contributions for eligible employees equal to 100% of elective deferrals that do not exceed 3% of an employee's compensation.

Unprocessed Election: On January 1, 2006, Pat, an employee, made an election to contribute 10% of compensation for the 2006 plan year. However, Pat’s election was not processed, and the required amounts were not withheld in 2006.

Pat’s compensation: $30,000.

Correction: ABC calculates the corrective QNEC to be made on behalf of Pat as follows:

(1) Elective deferrals: ABC must make a QNEC to the plan on behalf of Pat equal to the missed deferral opportunity for Pat, which is 50% of Employee Pat’s missed deferral. The QNEC is adjusted for earnings.

The missed deferral for Pat is determined by using Pat’s elected deferral percentage (10%) for 2006 and multiplying that percentage by Pat’s compensation for 2006 ($30,000).

Accordingly, the missed deferral for Pat, on account of the employee’s improper exclusion from the plan is $3,000 (10% x $30,000).
The missed deferral opportunity is $1,500 (i.e., 50% x $3,000). Thus, the required corrective contribution for the failure to provide Pat with the opportunity to make elective deferrals to the plan is $1,500 (plus earnings).

(2) **Matching contributions:** Pat should have been eligible for but did not receive an allocation of employer matching contributions because no elective deferrals were made on Pat’s behalf in 2006.

Thus, ABC must make a QNEC to the plan on behalf of Pat that is equal to the matching contribution Pat would have received had the missed deferral been made, adjusted for earnings.

Under the terms of the plan, if Pat had made an elective deferral of $3,000 or 10% of compensation ($30,000), Pat would have been entitled to a matching contribution equal to 100% of first 3% of Pat’s compensation ($30,000) or $900.

Accordingly, the contribution required to replace the missed employer matching contribution is $900 (plus earnings).

(3) The total required corrective QNEC, before adjustments for earnings, on behalf of Pat is $2,400 ($1,500 for the missed deferral opportunity plus $900 for the missed matching contribution).

b. **Short Term Misses**

Note, however, that in the case of certain brief exclusions, a special correction method may be available. Specifically, an employer is not required to make a corrective contribution with respect to elective deferrals or after-tax employee contributions (but is required to make a corrective contribution with respect to any matching contributions) for a plan year if the employee has been provided the opportunity to make elective deferrals or after-tax contributions under the plan for a period of at least the last 9 months in that plan year and during that period the employee had the opportunity to make elective deferrals or after-tax employee contributions in an amount not less than the maximum amount that would have been permitted if no failure had occurred. [Rev. Proc. 2008-50, Appendix B, 2.02(1)(a)(ii)(F)]

**Example 19:** Plan: 401(k) plan.

Eligibility: the plan has a one year of service eligibility requirement and provides for January 1 and July 1 entry dates.

Failure: Employee Y, who should have been provided the opportunity to elect to make elective deferrals on January 1, 2006, was not provided the opportunity to elect and make elective deferrals until July 1, 2006.

The employee made $5,000 in elective deferrals to the plan in 2006. The employee was a highly compensated employee with compensation for 2006 of $200,000. Employee Y’s compensation from January 1 through June 30, 2006 was $130,000. The ADP for highly compensated employees for 2006 was 10%. The ADP for nonhighly compensated employees for 2006 was 8%. The Section 402(g) limit for deferrals made in 2006 was $15,000.
Corrective contribution for missed deferral: Employee Y’s missed deferral is equal to the 10% ADP for highly compensated employees multiplied by $130,000 (compensation earned for the portion of the year in which Employee Y was erroneously excluded, i.e., January 1 through June 30, 2006). The missed deferral amount, based on this calculation, is $13,000. However, the sum of this amount ($10,000) and the previously made elective contribution ($5,000) is $18,000. The 2006 Section 402(g) limit for elective deferrals is $15,000. As such, the missed deferral needs to be reduced by $3,000, to ensure that the total elective contribution complies with the applicable Section 402(g) limit. Accordingly, the missed deferral is $7,000 ($10,000 - $3,000), and the required corrective contribution is $3,500 (i.e., 50% multiplied by the missed deferral of $7,000). The corrective contribution must be adjusted for earnings. [Rev. Proc. 2008-50, Appendix B, 2.02(1)(b), Example 6]

Example 20: Employer E maintains a Section 401(k) plan. The plan provides for matching contributions for each payroll period equal to 100% of an employee's elective deferrals that do not exceed 2% of the eligible employee's plan compensation during the payroll period. The plan also provides that the annual limit on matching contributions is $750. The plan provides for after-tax employee contributions. The after-tax employee contributions cannot exceed $1,000 during a plan year. The plan provides that employees who complete one year of service are eligible to participate in the plan on the next January 1 or July 1 entry date. Employee Z, a nonhighly compensated employee who met the eligibility requirements and should have entered the plan on January 1, 2006, was not offered the opportunity to participate in the plan. In March of 2006, the error was discovered and Employer E offered the employee an election opportunity as of April 1, 2006. Employee Z had the opportunity to make the maximum elective deferrals and/or after-tax employee contributions that could have been made under the terms of the plan for the entire 2006 plan year. The employee made elective deferrals equal to 3% of the employee's plan compensation for each payroll period from April 1, 2006 through December 31, 2006 (resulting in elective deferrals of $960). The employee's plan compensation for 2006 was $40,000 ($8,000 for the first three months and $32,000 for the last nine months). Employer E made matching contributions equal to $640 for the excluded employee, which is 2% of the employee's plan compensation for each payroll period from April 1, 2006 through December 31, 2006 ($32,000). After being allowed to participate in the plan, the employee made $500 in after-tax employee contributions. The ADP for nonhighly compensated employees for 2006 was 3% and the ACP for nonhighly compensated employees for 2006 was 2.3%. The portion of the ACP attributable to matching contributions for nonhighly compensated employees for 2006 was 1.8%. The portion of the ACP attributable to after-tax employee contributions for nonhighly compensated employees for 2006 was 0.5%.

Correction: Employer E uses the correction method for partial year exclusions to correct the failure to include an eligible employee in the plan. Because Employee Z was given an opportunity to make elective deferrals and after-tax employee contributions to the plan for at least the last 9 months of the plan year (and the amount of the elective deferrals or after-tax employee contributions that the employee had the opportunity to make was not less than the maximum elective deferrals or after-tax employee contributions that the employee could have made if the employee had been given the opportunity to make elective deferrals and after-tax employee contributions on January 1, 2006), under the special rule, Employer E is not required to make a corrective contribution for the failure to provide the employee with the opportunity to make either elective deferrals or after-tax employee contributions. The employer only needs to make a corrective contribution for the failure to provide the employee with the opportunity to receive matching contributions on deferrals that could have been made during the first 3 months of the
The calculation of the corrective contribution required to correct this failure is shown as follows.

The missed matching contribution is determined by calculating the matching contribution that the employee would have received had the employee been provided the opportunity to make elective deferrals during the period of exclusion, i.e., January 1, 2006 through March 31, 2006. Assuming that the employee elected to defer an amount equal to 3% of compensation (which is the ADP for the nonhighly compensated employees for the plan year), then, under the terms of the plan, the employee would have been entitled to a matching contribution of 2% of compensation. As such, Employer E determines compensation by prorating Employee Z's annual compensation for the portion of the year that Employee Z was not given the opportunity to make elective deferrals or after-tax employee contributions. Accordingly, the required matching contribution for the period of exclusion is obtained by multiplying 2% by Employee Z's compensation of $10,000 (3/12ths of the employee’s 2006 plan compensation of $40,000). Based on this calculation, the missed matching contribution is $200. However, when this amount is added to the matching contribution already received ($640), the total ($840) exceeds the $750 plan limit on matching contributions by $90. Accordingly, the missed matching contribution figure is reduced by $110 ($200 minus $90). The required corrective contribution is $110. The corrective contribution must be adjusted for earnings.[Rev. Proc. 2008-50,. Appendix B, 2.02(1)(b), Example 7]

Example 21: Omission of Eligible Employee—Assume that the ABC company maintains a profit sharing plan that benefits the owner and her husband, both of whom are employees of ABC. Over the years, Chris has worked there on a purely part time basis. Once Chris became a full time employee, ABC forgot to include Chris in the plan once Chris had satisfied the plan’s eligibility requirements. This exclusion went on for several years. To correct, would require a contribution of $67,000 to be made to the plan on behalf of Chris.

The failure cannot be self corrected. First, although the failure can be described as Operational, the failure to include the one non-highly compensated employee would likely be viewed as Significant having affected 100% of the employees that could have been affected and 100% of the plan’s eligible non-highly compensated participants. Moreover, in comparison to the total assets, the $67,000 may well be viewed as Significant.

As a likely Significant failure, the failure was not timely corrected and therefore could not be self corrected.

An additional reason that the failure could not be self corrected is that the failure to include the sole non-highly compensated employee also means that the plan failed to satisfy the coverage requirements, a Demographic failure. Demographic failures can only be corrected using VCP.

Correction: In correcting under VCP, the plan proposes, rather than having the employer make fresh contributions of $67,000, the accounts of the two participants, both of whom are considered highly compensated (the spouse, by virtue of being the spouse of a more than 5% owner of the business) will instead shift assets from their accounts, plus attributable earnings, sufficient that the total allocations among the three will instead be the amounts that would have been allocated had Chris been allowed to timely enter. This is known as the Reallocation Method of correction and can be used under very strict conditions. [Rev. Proc. 2008-50, Appendix B, Section 2.02(2)(a)(iii)]
c. Rules Governing Correction of Plan Loan Failures—Not Available to Self Correct

Unless correction is made in accordance with the guidance, a deemed distribution in connection with a loan failure must be reported on Form 1099-R with respect to the affected participant and any applicable income tax withholding amount that was required to be paid in connection with the failure (see Treas. Reg. §1.72(p)-1, Q&A-15) must be paid by the employer. As part of VCP, 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. [Rev. Proc. 2008-50, part III, Section 6.07(1)]

Rev. Proc. 2008-50 sets forth correction methods that are only available for plan loan failures that are corrected through VCP. However, the methods are not available if the maximum period for repayment of the loan, pursuant to Section 72(p)(2)(B), has expired. Moreover, the IRS reserves the right to limit the use of the correction methods to situations that it considers appropriate, for example, where the loan failure is caused by employer action. A deemed distribution corrected by use of one of the allowable methods is not required to be reported on Form 1099-R and repayments made by correction do not result in the participant having additional basis in the plan for purposes of determining the tax treatment of subsequent distributions from the plan to the affected participant. [Rev. Proc. 2008-50, part III, Section 6.07(2)(a)]

Moreover, in order for a plan loan to eligible for relief under VCP and avoid treatment as a deemed distribution, correction should have been accomplished within the maximum allowable duration for the loan provided for under IRC 72(p)(2)(B) (generally 5 yrs.) measured from the date of the loan.

(1). Loans that are larger than Permitted

Where the failure is the failure to comply with plan provisions requiring that loans comply with Section 72(p)(2)(A), the participant must repay the excess loan amount and, if necessary, reform the loan to amortize the remaining principal balance as of the date of repayment over the remaining period of the original loan.

The corrective payment for the excess loan amount depends on: (1) the amount of the excess as of the date of the loan; (2) the payments previously made on the loan, and (3) the portion of the previously made payments that were allocated to the excess loan amount.

There are three alternative methods that can be used to determine the allocation of prior repayments toward the excess loan amount and the corrective payment required to repay the excess loan amount:

(1) **Method #1**: Prior repayments are applied solely to reduce the portion of the loan that did not exceed the maximum loan amount (so that the corrective repayment would equal the original loan excess plus interest);

(2) **Method #2**: Prior repayments are used pay the interest on the portion of the loan in excess of the limit, with the remainder of the repayments used to reduce the portion of the loan that did not exceed the limit; the corrective payment for the excess loan amount is equal to the original excess loan amount, or
(3) **Method #3:** Prior repayments are applied, pro rata, against the loan excess and the maximum loan amount permitted under Section 72(p); the corrective repayment would equal the outstanding loan balance attributable to the excess loan amount, after the allocation of prior repayments.

The maximum duration is to be determined from the date of the original loan was made. In addition, the amortization payments determined for the remaining period must comply with the level amortization requirements of Section 72(p)(2)(C).

**Example 22:** ABC 401(k) plan has a participant loan policy. Lee, a participant in the plan, has a vested account of $200,000 and therefore can borrow a maximum of $50,000. Lee, however, through an administrative error, is allowed to instead borrow $60,000.

ABC decided to correct the mistake under VCP using Method #3. Since Lee has already repaid some of the loan, these repaid amounts may be taken into account in determining the amount of the required corrective repayment.

ABC applies Lee’s prior repayments on a pro rata basis between the $10,000 loan excess and the $50,000 maximum loan amount applicable to Lee.

As such Lee’s corrective repayment equaled the balance remaining on the $10,000 loan excess as of February 1, 2009, the date of correction.

(2). **Loans that Exceed the Maximum Permissible Period**

Where the failure is the failure to provide for a repayment schedule that complies with Section 72(p)(2)(B) or (C), the failure may be corrected by a reamortization of the loan balance in accordance with Section 72(p)(2)(C) over the remaining period that is the maximum period that complies with Section 72(p)(2)(B) (generally, 5 years) measured from the original date of the loan.

(3). **Defaulted Loans**

In the case of a defaulted loans, that is, the failure to repay the loan in accordance with the loan terms where the terms satisfy Section 72(p)(2), the failure may be corrected by: (1) a lump sum repayment equal to the additional repayments that the affected participant would have made if there had been no failure to repay, plus interest accrued on the missed repayments, (ii) reamortizing the outstanding balance, including accrued interest, over the remaining payment schedule of the original term of the loan or (iii) any combination of the two.


Correction requires that the participant either:

- make a lump sum payment for the missed installments (adjusted for interest);
- reamortize the outstanding balance of the loan, resulting in higher payments going forward, or
• a combination of a make-up payment and reamortization of the loan

(4) Special Correction Principle for Loans

Generally, in the case of the correction of a loan failure, the participant is responsible for paying the corrective payment. However, with respect to the correction of a loan in default in accordance with the correction method allowed under the revenue procedure, (essentially, allowing a lump sum repayment of the missed payments and accrued interest and re-amortization of the remaining balance), Revenue Procedure 2008-50 provides that the employer should pay a portion of the correction payment on behalf of the participant equal to the interest that accumulates as a result of the failure—generally determined at the rate equal to the greater of the plan loan rate or the rate of return under the plan. [Rev. Proc. 2008-50, Part III, Section 6.02((6)]

(5) Don’t Forget Plans Own Permitted Grace Period

Plans should not forget that the plan may be able to avoid a default by making sure that the plan’s loan policy includes a grace period which can be used before the plan declares a loan in default. The grace period cannot extend beyond the last day of the calendar quarter following the calendar quarter in which the required installment was due. [Treas. Reg. Section 1.72(p)-1, Q & A 10]

(6) Plan Terminated Prior to Adopting Necessary Amendments

Example 23: A one person business maintains a profit sharing plan using a brokerage prototype. The owner decides to terminate the plan and does so by rolling over the proceeds to an IRA. After speaking with an advisor, it is discovered that she terminated prior to the plan being timely adopted to reflect changes required by EGTRRA (the Economic Growth and Tax Relief Reconciliation Act of 2001) or PPA (the Pension Protection Act of 2006). This is common problem because prototype plans will require a significant amount of time before necessary amendments can be approved by the IRS and the individual client’s documents amended to reflect the changes. While on-going plans may have an extended period of time in which to adopt the necessary amendments, the termination of a plan cuts off that extension and the plan must be amended, prior to termination, to reflect all then changes in the law then in effect.

The result is that, at the time of the termination and rollover to an IRA, the plan lacked the necessary amendments to be tax qualified. This means not only was the money disqualified, but the rollover to the IRA also means that potentially, the 6% excise tax will be applied on the ineligible rollover until distribution.

Correction Proposed and Approved under VCP: The proceeds are rolled back into an account in the name of the plan. The plan will remain in effect until the brokerage firm has available a prototype document that reflects EGTRRA as well as then all applicable provisions of the PPA.

(7) Correcting Spousal Consent Failures

One of the most difficult issues for both the IRS and the plan is dealing with failures to obtain proper spousal consent in a plan subject to the joint and survivor requirements of Code Section 401(a)(11).

Generally, the correction method under VCP requires that the spouse (to whom the participant was married at the time) and participant are to be notified that the spouse can provide spousal consent to the
prior distribution or the participant can repay the distribution and receive a qualified joint and survivor annuity. In the event that participant or spousal consent is required but cannot be obtained, the participant must receive a qualified joint and survivor annuity based on the monthly amount that would have been provided under the plan at his or her retirement date. This annuity may be actuarially reduced to take into account distributions already received by the participant. However, the portion of the qualified joint and survivor annuity payable to the spouse upon the death of the participant may not be actuarially reduced to take into account prior distributions to the participant. Thus, for example, if, in accordance with the automatic qualified joint and survivor annuity option under a plan, a married participant who retired would have received a qualified joint and survivor annuity of $600 per month payable for life with $300 per month payable to the spouse for the spouse's life beginning upon the participant's death, but instead received a single-sum distribution equal to the actuarial present value of the participant's accrued benefit under the plan, then the $600 monthly annuity payable during the participant's lifetime may be actuarially reduced to take the single-sum distribution into account. However, the spouse must be entitled to receive an annuity of $300 per month payable for life beginning at the participant's death.

Instead, such a failure may be corrected under VCP using one of the following alternatives.

First, if spousal consent to the prior distribution is not obtained, (for example, because the spouse chooses not to consent, the spouse does not respond to the notice or the spouse cannot be located) the spouse is entitled to a benefit equal to the portion of the qualified joint and survivor annuity that would have been payable to the spouse upon the death of the participant had a qualified joint and survivor annuity been provided to the participant under the plan at the annuity starting date for the prior distribution. Such spousal consent must be provided if a claim is ever made by the spouse.

In the alternative, if spousal consent to the prior distribution is not obtained, the plan may offer the spouse the choice between: (i) the survivor annuity benefit described above or (ii) a single sum payment equal to the actuarial present value of that survivor benefit (calculated using the applicable interest rate and mortality table under Section 417(e)(3). Any such single-sum payment is treated in the same manner as a distribution under Section 402(c)(9) for purposes of rolling over the payment to an IRA or other eligible retirement plan.


Example 24: A company uses a prototype profit sharing plan. Profit sharing plans can be drafted to be exempt from the spousal consent requirements by providing that death benefits will be automatically paid to the participant’s spouse and by not allowing the transfer into the plan of any funds from a plan subject to the joint and survivor requirements.

The prototype plan provides for this exemption but also, confusingly, the Adoption Agreement also allows for use of a participant’s account to purchase an annuity upon distribution. Although this option had been checked yes, the plan had not treated the plan as a plan subject to the joint and survivor requirements. The vendor and provider of the document, which also administered the plan, had no mechanism in place for requiring or obtaining spousal consent. Ancillary documents were also confusing as to whether the plan was intended to comply with the joint and survivor option given that other provisions of the plan document purported to provide for the exemption from the joint and survivor annuity requirements.
Correction Proposed and Accepted:

The plan argued that the election of the annuity option was not intended to provide for annuitization under the plan, that is, distribution in an annuity form from the plan, but rather, was instead intended to allow participants, on distributions, to purchase an annuity contract in their own name which would then be portable. Thus, we argued, the plan should not be forced to treat the failure as a joint and survivor failure (and thus, be forced to provide a survivor annuity option to spouses who fail to retroactively agree to the form of distribution actually taken).

Rather, the plan proposed, and the IRS accepted, correction whereby the plan would notify the participants whose accounts exceeded $5,000 (and therefore, under the terms of the plan could not be mandatorily cashed out in a lump sum without the ability to elect alternative forms of distribution) the option to repay the lump sum previously received.

If the participant opted to repay, the plan would then use its market powers to find an annuity contract that could be purchased with the proceeds. However, because the plan was treating this as merely the failure to offer the participant the right to, for him/herself and in his or her own name, purchase an annuity, and not as an election of an annuity option under the plan, the proposed correction would neither include notification to the spouse nor the provision of a survivor benefit.

(8) Sample Employer Eligibility Failure

Example 25: The ABC company maintains SIMPLE IRAs for its 98 employees. Unfortunately, the company failed to take into consideration the employees of its subsidiary, DEF. After taking these employees into consideration, the company fails to constitute an “eligible employer” for purposes of being able to maintain a SIMPLE.

Correction Allowed:

ABC must cease all contributions to the plan, including employee contributions not later than when application is made under VCP. The assets will remain in the SIMPLE IRAs and can only be distributed in accordance with the rules that apply to SIMPLE IRAs.

Although no more contributions can be made to the plan, correction under VCP allows the plan to treat itself as SIMPLEs for those with accounts for purposes of subsequent distributions. Thus, future distributions will be treated as distributions from a SIMPLE.

G. What to Expect when Uncorrected Failures are discovered on Audit

1. Audit CAP

When a Qualification Failure is discovered on audit that has not previously been self corrected (if available) or corrected using VCP, the agent will likely offer correction using Audit CAP (the Audit Closing Agreement Program) assuming that the plan and the failures are otherwise eligible.

If not, or if agreement cannot be reached under Audit CAP, the agent will likely propose to disqualify the plan.
CAP is available to correct both form and operational failures. CAP is also available to correct egregious failures. However, Audit CAP is not available to correct failures relating to the diversion or misuse of plan assets. [Rev. Proc. 2008-50, Part II, Section 4.11, 4.12]

a. Abusive Tax Avoidance Arrangements

If the plan is under audit, for purposes of both self correction and CAP, if the IRS determines that the plan or the plan sponsor was or may have been a party to an abusive tax avoidance transaction, the matter may be referred to the Service's Employee Plans’ Tax Shelter Coordinator.

If the IRS determines that the failure was related to the abusive tax avoidance transaction, the IRS reserves the right to conclude that neither CAP nor self correction is available for that failure and if the IRS determines that satisfactory corrective actions have not been taken with regard to the transaction, the IRS reserves the right to conclude that neither CAP nor self correction is available to the plan.

For this purpose, that is, in the case of a plan under examination, an abusive tax avoidance transaction means any listed transaction under Treas. Reg. Section 1.6011-4(b)(2) and any other transaction identified as an abusive transaction in the IRS web site entitled “EP Abusive Tax Transactions.” [Rev. Proc. 2008-50, Part II, Section 4.13]

b. Entry into Closing Agreement Requiring Full Correction

A Closing Agreement is an agreement pursuant to statute designed to resolve issues in dispute between the IRS and taxpayers. Generally, a Closing Agreement is final and can be revoked only upon a showing of fraud, malfeasance, or misrepresentation of a material fact.

If available and used where qualification defects are discovered during the examination of a plan, the plan may avoid actual disqualification through the negotiation of a Closing Agreement with the IRS, full correction, and the payment of a monetary sanction.

Whether the correction is full and complete is determined by applying the same Overriding Correction Principles previously discovered.

Note, however, no negotiations of the sanction amount or closure under CAP should be entered into by the plan unless the plan first determines that it is not eligible to self correct the failures because the failures are either not Operational Failures, or are not Insignificant, or the plan fails to satisfy the Practices and Procedures required to be able to self correct. It is important to remember that self correction of Insignificant Operational Failures can occur at any time, even if the plan is under audit and even if the agent discovers the failures.

If the plan determines that self correction is in fact not available, and the IRS and the plan sponsor are unable to reach agreement under Audit CAP, for example, if the parties cannot reach agreement with respect to the correction or the monetary sanction, the plan will be disqualified.

c. Payment of Sanction—Likely to be Significant

Under Audit CAP, the plan sponsor is required to pay a monetary sanction that is a negotiated percentage of the Maximum Payment Amount. The revenue procedure states that the sanction is not to be excessive and is to bear some relationship to the nature, extent, and severity of the failures.
The Maximum Payment Amount is the amount that is approximately equal to the tax the Service could collect upon disqualification of the plan and is the sum for the open taxable years of the:

1. Tax on the trust;

2. Additional income tax resulting from the loss of the employer deductions for plan contributions (and any interest and penalties applicable to the plan sponsor's return); and

3. Additional income tax resulting from income inclusion for the participants.

If the failures include loan failures, the Maximum Payment Amount will include the tax the IRS could collect as a result of the loan not being excluded from gross income. [Rev. Proc. 2008-50, Part VI, Section 14.01]

In determining the exact amount of the sanction to be assessed, a number of factors are to be taken into consideration. The factors to be taken into consideration relate to the nature, extent, and severity of the failures, including the extent to which correction had progressed before the examination was initiated based upon the following:

1. the steps taken by the plan sponsor to ensure that the plan had no failures;

2. the steps taken to identify failures that may have occurred;

3. the extent to which correction had progressed before the examination was initiated, including full correction;

4. the number and type of employees affected by the failure;

5. the number of non-highly compensated employees who would be adversely affected if the plan was not treated as qualified;

6. whether the failure is a failure to satisfy the requirements of Section 401(a)(4), Section 401(a)(26), or Section 410(b);

7. the period over which the failure occurred (for example, the time that has elapsed since the end of the applicable remedial amendment period for a Plan Document failure);

8. the reason for the failure, for example, data errors, the transposition of numbers, or minor arithmetic errors;

9. whether the plan is subject to a favorable determination letter;

10. whether the plan has both Operational and other failures;

11. the extent to which the plan has accepted transferred assets and the extent to which failures relate to transferred assets that occurred before the transfer, and

12. whether the failures were discovered during the determination letter process.
If one of the failures discovered on audit is the failure to amend the plan timely, it is anticipated that the sanction amount will be greater than the otherwise applicable fee that would be charged where the failure is discovered during a determination letter application submission set forth below. [Rev. Proc. 2008-50, Part VI, Section 14.02]

(1) Attributable to Transferred Assets

However, in all events, a reduced fee may apply where the failures applies to a plan with transferred assets. Specifically, if the IRS determines that no new incidents of the failure that relates to the transferred assets occurred after the end of the second plan year that begins after the corporate merger, acquisition, or similar employer transaction, the monetary sanction is not to exceed the sanction that would apply if the transferred assets were maintained as a separate plan. [Rev. Proc. 2008-50, Part VI, Section 14.03]

(2) Payment of CAP Sanction

The IRS generally takes the position that all CAP sanctions should be paid by someone other than the plan trust.

However, in a Field Directive, the IRS sets forth the limited circumstances under which it will consider payment from the trust to be acceptable. Because the primary concern with respect to such manner of payment is the exclusive benefit rule, the Directive was issued after first being coordinated with the Department of Labor.

Under a Field Directive dated February 21, 1995, the IRS reiterates its general rule that ordinarily, CAP sanctions should be paid by a party other than the trust, such as the employer, responsible fiduciaries, or their insurers. It is not necessary that the payor be the party responsible for the disqualifying violation.

In the following limited circumstances, trust assets may be used to help meet the cost of sanctions:

1. The employer has insufficient assets to pay, due to significant financial distress; the employer’s tax liability upon disqualification would be nominal, or relatively insignificant compared to that of the trust, and the adverse consequences of plan disqualification would fall most heavily on non-highly compensated participants;

2. The accrued benefit of the party responsible for the violation who is also a participant provided the party is currently entitled to a distribution, the consent requirements of Sections 411(a)(11) and 417 have been satisfied, and the portion that the participant directs to be used for this purpose is paid in a revocable arrangement that satisfies the requirements of Treasury Regulation § 1.401(a)-13(e);

3. In the case of multiemployer plans and third-party fiduciaries, where it may be difficult to secure payment, after all other such sources have been exhausted, from the trust.

In the first circumstance, the agent must request technical advice from the Service regarding whether the payment from the trust is a use of plan assets for the benefit of a fiduciary or other disqualified party in violation of the prohibited transaction provisions.

41
(a) Fee where Nonamender Discovered on Determination Letter Application

Where a failure to timely amend is discovered during the determination letter application process, the applicable fee is determined in accordance with the following chart:

<table>
<thead>
<tr>
<th>Number of Participants</th>
<th>EGTRRA/ (subsequent legislation)</th>
<th>GUST/ 401(a)(9) Regs.</th>
<th>UCA/ OBRA ‘93</th>
<th>TRA ‘86</th>
<th>T/D/R</th>
<th>ERISA</th>
</tr>
</thead>
<tbody>
<tr>
<td>20 or less</td>
<td>$ 2,500</td>
<td>$ 3,000$</td>
<td>3,500</td>
<td>$ 4,000</td>
<td>$ 4,500</td>
<td>$ 5,000</td>
</tr>
<tr>
<td>21-50</td>
<td>$ 5,000</td>
<td>$ 6,000</td>
<td>$ 7,000$</td>
<td>8,000</td>
<td>$ 9,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>51-100</td>
<td>$ 7,500</td>
<td>$ 9,000</td>
<td>$10,500</td>
<td>$12,000</td>
<td>$13,500</td>
<td>$15,000</td>
</tr>
<tr>
<td>101-500</td>
<td>$12,500</td>
<td>$15,000</td>
<td>$17,500</td>
<td>$20,000</td>
<td>$22,500</td>
<td>$25,000</td>
</tr>
<tr>
<td>501-1000</td>
<td>$17,500</td>
<td>$21,000</td>
<td>$24,500</td>
<td>$28,000</td>
<td>$31,500</td>
<td>$35,000</td>
</tr>
<tr>
<td>1001-5000</td>
<td>$25,000</td>
<td>$30,000</td>
<td>$35,000</td>
<td>$40,000</td>
<td>$45,000</td>
<td>$50,000</td>
</tr>
<tr>
<td>5001-10,000</td>
<td>$32,500</td>
<td>$39,000</td>
<td>$45,000</td>
<td>$52,000</td>
<td>$58,500</td>
<td>$65,000</td>
</tr>
<tr>
<td>over 10,000</td>
<td>$40,000</td>
<td>$48,000</td>
<td>$56,000</td>
<td>$64,000</td>
<td>$72,000</td>
<td>$80,000</td>
</tr>
</tbody>
</table>


IV. Failure to Timely File Form 5500

Both the Code and ERISA impose penalties for the failure to file or for the late filing of the annual return.

A. DOL Penalty

The Secretary of Labor is authorized to assess a penalty of up to $1100 per day from the date of the administrator's failure or refusal to file the annual 5500. For this purpose, a filed 5500 that has been rejected for failure to provide material information is treated as not having been filed with the Secretary. [ERISA § 502(c)(2)] Subject to the $1100 per day ceiling, the exact amount of the penalty is within the discretion of the DOL. The DOL announced in a press release that plan administrators who file an annual reports for 1988 and subsequent years beyond the due date, with extensions, will be considered late filers.
and may be assessed up to $50.00 per day per return for the period of the delinquency. In the case of a plan administrator that fails to file, the DOL may assess a penalty of up to $300 per day per plan up to a maximum penalty of $30,000 per year for each plan until the return is properly filed.

Upon issuance of a notice of intent to assess a penalty, the plan administrator has 30 days to file a statement demonstrating reasonable cause and requesting an abatement of the penalties. The statement must contain a declaration that it is made under penalties of perjury. [29 CFR § 2560.502c-2(e)]. If the penalty is assessed, all administrators responsible for the filing are to be jointly and severally liable for the penalty and are to be personally liable. [29 CFR § 2560.502c-2(j)].

B. IRS Penalty

Unless it is shown that the failure was due to reasonable cause, the Secretary of the Treasury may also impose a fine for the same. The IRS can impose a penalty of up to $25.00 for each day during which the failure to file the Annual Report continues, not to exceed $15,000 per return. [IRC § 6652(e)]. The penalty may be assessed where the form is filed but is incomplete.

C. DOL Voluntary Correction Program

The DOL has instituted the Delinquent Filer Voluntary Compliance ("DFVC") Program. Under DFVC, plan administrators, otherwise subject to the assessment of higher civil penalties will be allowed to file subject to reduced penalties. The DFVC is only available in the case of plans that file voluntarily under the program. As such, the administrator must not have been notified in writing of the DOL's intention to assess civil penalties for failure to file or late filing nor have been notified in writing by the DOL of the failure to timely file the form 5500.

Although the IRS is authorized to also assess penalties for the failure to file the same return and does not maintain a comparable program, the IRS has announced that it will not assess penalties for the late filing of form 5500s that are filed pursuant to the DFVC program. A separate application is not required to be filed with the IRS in order to obtain this relief. [IRS Notice 2002-23, IRB 2002-15, April 15, 2002]

In the case of a small plan, that is, a plan with fewer than 100 participants at the beginning of the plan year, the penalty amount is $10 per day for each day the return is late not to exceed the greater of $750 per annual return or, in the case of a submission including multiple returns, $1,500 per plan. In the case of a plan with 100 or more participants at the beginning of the plan year, the daily penalty is also $10, but not to exceed the greater of $2,000 per return or, in the case of multiple returns, $4,000 per plan. [67 Fed. Reg. 15,051, March 28, 2002, Section 3]

V. Dealing with Required Minimum Distribution Failures

A. Background on Required Minimum Distributions

Distribution from a qualified plan is generally required to begin not later than the participant's "required beginning date". The definition of "required beginning date" will depend upon whether the individual is or is not a 5% owner.

In the case of all participants in a qualified plan other than 5% owners with respect to the plan year ending in the calendar year in which the employee attains age 70 1/2, the "required beginning date" means April 1 of the calendar year following the later of:
(i) the calendar year in which the employee attains age 70 1/2, or

(ii) (except in the case of a 5% owner as described above), the calendar year in which the employee retires.

In the case of a 5% owner, subject to certain grandfather provisions, the "required beginning date" means April 1st of the calendar year following the calendar year in which the employee attains age 70 1/2 without regard to whether the participant has terminated employment.

An individual is treated as a 5% owner if the employee is a more than 5% owner of the employer with respect to the plan year ending with or within the calendar year in which the individual attains age 70 1/2.

Once distributions have begun to a 5% owner, determined in accordance with this definition, distribution must continue, even if the participant ceases to be a 5 percent owner in a subsequent year.

[ IRC §401(a)(9)(C)(i) and (ii)]

The failure to timely distribute required minimum distributions generally leads to the imposition of a 50% excise tax on the distribute who failed to receive the required distribution. [IRC Section 4974]

B. Getting the Excise Tax Waived under VCP or Audit CAP

While generally matters that result in an excise tax do not qualify for either self correction or for correction under VCP or Audit CAP, because the failure to satisfy the required minimum distribution requirements generally means a failure to follow the terms of the plan, special rules apply for submissions under VCP or when found under Audit CAP.

As part of a VCP submission, in appropriate cases, the IRS will waive the excise tax under Section 4974 applicable to plan participants. The plan sponsor must request the waiver and in cases where the participant subject to the excise tax is an owner-employee, as defined in Section 401(c)(3), or a 10 percent owner of a corporation, the plan sponsor must also provide an explanation supporting the request. [Rev. Proc. 2008-50, Part III, Section 6.09(2)]

Under Audit CAP, the plan sponsor must make a specific request for the waiver of the excise tax. The plan sponsor is also to provide an explanation supporting the request for the waiver. Upon reviewing the request, the reasons for the failure, and other facts and circumstances of the case under examination, the IRS will determine whether it is appropriate to approve the waiver under Audit CAP. [Rev. Proc. 2008-50, Part III, Section 6.09(2)]

C. Dealing with the Excise Tax without going through VCP or Audit CAP

While self correction is not available as a means to waive the 50% excise tax on missed required minimum distributions, there may be another option available to attempt to avoid the imposition of the excise tax without making submission under VCP and outside of the Audit CAP process.

Regulations under Section 4974 contain an automatic waiver in the case of an individual where the shortfall was due to a reasonable error and reasonable steps are taken to remedy the failure. Previously, the IRS required that the individual pay the excise tax upfront and request a refund. Now, the individual
can request a refund under this rule without first paying any portion that he/she request be waived. [See instructions to Form 5329]

VI. DOL Fiduciary Voluntary Correction Program

The DOL has also established a program pursuant to which certain plan officials (i.e., a plan fiduciary, plan sponsor, party in interest with respect to the plan, or other person who is in a position to correct a breach) can voluntarily correct certain fiduciary breaches.

Under the Voluntary Fiduciary Correction (VFC) program, the DOL will issue an applicant a "no-action letter" with respect to a breach identified in the application provided the breach is one available for correction under the program and correction is made. The relief provided applies only to the breach and persons identified in the no-action letter. If a transaction gave rise to violations not addressed in the program, such as failure to diversify plan assets, the relief afforded by VFC would not extend to such additional violations. The issuance of a no-action letter pursuant to the program will not bind other agencies from enforcing any rights or to carry out any authority they may have regarding the breach. However, the IRS has consented to this method of correcting certain prohibited transactions so that it will not assess its prohibited transaction penalties with respect to violations corrected under VFC.

Currently, breaches eligible for correction under VFC include:

1. Delinquent participant contributions including Section 401(k) contributions and participant loan repayments;
2. Fair market interest rate loans to a party in interest;
3. Below-market interest rate loan to a person who is not a party in interest;
4. Below-market interest rate loan solely because of delay in perfecting security interest;
5. Purchase of an asset (including real property) by a plan from a party in interest;
6. Sale of an asset (including real property) by a plan to a party in interest;
7. Sale and leaseback of real property to sponsoring employer;
8. Purchase of an asset (including real property) by a plan from a non-party in interest at other than fair market value;
9. Payment of benefits without properly valuing plan assets on which payment is based;
10. Payment of duplicate, excessive, or unnecessary compensation;
11. Payment of dual compensation to plan fiduciaries;
12. Holding of illiquid asset previously purchased by the plan;
13. Correction of participant loans that violate both Section 72(p) and the plan's terms,
14. Defaulted participant loans;

15. Participant loans failing to comply with plan provisions for amount, duration or level amortization;

16. Failure to timely remit loan repayments to the plan, and

17. Use of plan assets to pay expenses that should have been paid by the employer.

Correction generally requires that benefits be restored to the plan and to plan participants as if the breach had never occurred. Restoration includes restoration of lost earnings and the program sets forth methods for calculating loss earnings. No negotiation takes place with respect to the method of correction.