IRS Revenue Procedure Eases Correction Procedures (Posted on April 22, 2019 by Carol V. Calhoun)

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The IRS has just issued a new revenue procedure, Rev. Proc. 2019-19, which limits the number of plans that have to make IRS filings under the Voluntary Correction Program ("VCP") in order to correct past errors.

The guidance adds provisions allowing plans to be corrected under the Self-Correction Program ("SCP"), which does not require an IRS filing, in the case of two sorts of errors:

- Plan document failures
- Correction by retroactive plan amendment

The revenue procedure also loosens certain requirements for dealing with plan loan failures.

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Plan Document Failures

For plan document failures, the general rule is that SCP can be used only if:

- the plan is subject to a Favorable Letter and
- the correction is made within the SCP correction period.

In the case of an individually designed plan, "Favorable Letter" means a favorable determination letter with regard to the plan, no matter when it was issued. In the case of a pre-approved plan, it means a favorable letter that is still current. If the plan was terminated in the middle of a pre-approved plan cycle, the plan must have been amended to reflect the qualification requirements that applied as of the date of termination.

The SCP correction period generally extends to the last day of the second plan year following the plan year for which the failure occurred, unless the IRS commences an examination of the plan before then. For example, if a calendar year plan document failure occurred in 2017, the sponsor would need to correct the problem by the end of 2019. Hence, the general rule is likely to be of little immediate effect, inasmuch as the Required Amendments List for 2017 affected only a very limited group of plans, and there were no required amendments at all for 2018.

However, an extension to the SCP correction period is available n the case of a failure that relates only to transferred assets, or to a plan assumed in connection with a corporate merger, acquisition, or other similar employer transaction. In that case, the correction period does 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 an assumed plan. This can provide significant relief in the case of corporate transactions. While the purchaser in such transactions will normally require representations and warranties that the seller's plans meet qualification requirements, it is common to discover after the fact that there are problems. The purchaser having the ability to correct problems on its own under SCP, rather than attempting to enforce the warranties against the seller, will no doubt ease many corporate transactions.

Correction by Retroactive Plan Amendment

The rules for correction by plan amendment have been greatly loosened by the revenue procedure. Such correction is appropriate in instances in which a plan was not operated in accordance with its terms. Such an operational failure may be corrected under SCP by an appropriate plan amendment if three conditions are satisfied:

- the plan amendment would result in an increase of a benefit, right, or feature,
- the increase in the benefit, right, or feature is available to all eligible employees, and
- providing the increase in the benefit, right or feature is permitted under the Code.

For example, suppose that a plan provided only for a lump sum benefit, but had been permitting any participant to elect installment payments over five years. The installment payments would not themselves have been objectionable, but in the absence of a correction, they would violate the rules that a plan must be operated in accordance with its terms. The plan sponsor could simply elect to amend the plan retroactively under SCP to permit the installment payments.

Plan Loan Failures

Increased Availability of SCP

In determining whether a plan loan failure can be corrected under SCP, the first question is whether the failure is one covered by the Department of Labor's Voluntary Fiduciary Correction Program ("VFCP"). The VFCP provides for a no-action letter for a defaulted loan failure corrected under VCP, provided the conditions of the VFCP are met. However, the same relief does not apply if the loan failure is corrected under SCP. Loan issues that cannot be corrected under SCP for that reason are as follows:

- Plan sponsor's failure to transmit participant loan repayments on a timely basis
- Participant loans failing to comply with plan provisions for amount, duration, or level amortization
- Participant loans defaulted due to the sponsor's failure to deduct loan payments from the participant's wages

Certain other loan failures are newly permitted to be corrected under SCP. These are:

- Failure to obtain spousal consent to a loan, if the spouse consents once the error is discovered. (If the spouse does not consent, the failure must be corrected under VCP.)
- A failure of a loan to comply with the terms of the plan document (e.g., granting a second loan when a first is outstanding, in violation of the plan) can be corrected by retroactive plan amendment, if the conditions discussed above for correction by retroactive plan amendments are met.

Reporting of deemed distributions

If a plan loan failure is not corrected, the plan sponsor must treat is as a deemed distribution, and report it on a Form 1099-R. Previously, the amount was required to be reported in the year of the failure, unless the plan sponsor requested as part of VCP that it be reported in the year of the correction. The revenue procedure now permits the Form 1099-R to be issued for the year of the correction, without the plan sponsor having to make the request.

Conclusions

The new revenue procedure should limit the situations in which plan sponsors are required to file under VCP. This is particularly welcome given that the procedures for filing VCP submissions became more complex on April 1. The new procedures require online filing and payment, upload of documents up to 25 megabytes, and faxing documents in excess of the upload limit. (This requirement was first announced in Rev. Proc. 2018-52, and is continued in 2019-19.)