

The University of Texas School of Law

65th Annual Taxation Conference

EPCRS and Retirement Plans: A Misunderstood Relationship

December 13, 2017

EPCRS A Review

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EPCRS A Review

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EPCRS

A Review

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I. Introduction.

- A. Audit Activity. Since the 1940s, the Internal Revenue Service (the “Service”) has been issuing determination letters with respect to the qualification of retirement plans. In the late 1980s, it made a major shift in emphasis as it began devoting serious attention to audits of such plans in order to determine operational compliance. For example, in 1987, the Service performed approximately 5,000 examinations, but by 1989, it was conducting more than 32,000 examinations annually. General Accounting Office, “Pension Plans: IRS Needs to Strengthen Its Enforcement Program” 1, 3 and 6 (July 2, 1992), cited in Oshinsky, “Employee Plans: Guidelines for the Resolution of Qualification Violations”, Tax Management Comp. Planning J. 167, fn. 3 (August 7, 1992). From 1989 through 1991, the Service averaged over 30,000 audits per year, a reported coverage rate of approximately 3.5 percent, and the Service’s informally stated goal for some time was to devote at least half of its Employee Plans function to audits. Speech to American Bar Association Section on Taxation by James J. McGovern, Internal Revenue Service Assistant Commissioner, Employee Plans and Exempt Organizations, on January 28, 1995; Mustone, “An Overview of IRS Enforcement Procedures and Programs for Tax Qualified Plans”, 19 J. of Pens. Planning & Compliance, No. 2, 26 (Summer 1993). Episodic floods of determination letter applications and personnel challenges have slowed the Service’s audit activity.

Since this outline was first prepared, it has attempted to chronicle the development of various administrative alterations created to allow government agencies charged with enforcing ERISA to encourage compliance by allowing the correction of mistakes without unduly harsh penalties. Over the years since the first program was formally announced, a variety of programs developed without a lot of apparent coordination. The Service made a major step towards consolidating most of its programs by creating the “Employee Plans Compliance Resolution System” (“EPCRS”) described in Revenue Procedure 98-22, 1998-1 C.B. 723 (March 23, 1998) (“Rev. Proc. 98-22”). EPCRS was modified in January 1999 to include a variety of correction alternatives for plans and programs intended to satisfy section 403(b) of the Internal Revenue Code of 1986, as amended (“Code”), (“403)(b) Plan”) by Revenue Procedure 99-13, 1999-1 C.B. 409 (February 1, 1999) (“Rev. Proc. 99-13”). Reliable correction guidance was issued in Revenue Procedure 99-31, 1999-2 C.B. 280 (August 23, 1999) (“Rev. Proc. 99-31”). Rev. Proc. 98-22 was superseded by Revenue Procedure 2000-16,

2000-1 C.B. 518 (February 7, 2000) (“Rev. Proc. 2000-16”). Rev. Proc. 99-13 and Rev. Proc. 99-31 were also consolidated into Rev. Proc. 2000-16. Rev. Proc. 2000-16 was modified and superseded by Revenue Procedure 2001-17, 2001-1 C.B. 589 (February 12, 2001) (“Rev. Proc. 2001-17”), which in turn was superseded by Revenue Procedure 2002-47, 2002-2 C.B. 133 (July 22, 2002). Revenue Procedure 2003-44, 2003-1 C.B. 1051 (June 23, 2003) (“Rev. Proc. 2003-44”) and Revenue Procedure 2006-27, 2006-1 C.B. 945 (May 30, 2006) (“Rev. Proc. 2006-27”) were next. Rev. Proc. 2006-27 was modified by Revenue Procedure 2007-49, 2007-2 C.B. 141 (July 23, 2007) and was modified and superseded by Revenue Procedure 2008-50, 2008-2 C.B. 464 (September 2, 2008) (“Rev. Proc. 2008-50”). Next in this progression was Revenue Procedure 2013-12, 2013-4 I.R.B. 313 (January 3, 2013) (“Rev. Proc. 2013-12”) which modified and superseded Rev. Proc. 2008-50. The Service made changes to Rev. Proc. 2013-12 in Revenue Procedure 2015-27, 2015-16 I.R.B. 914 (March 28, 2015) (“Rev. Proc. 2015-27”), and Revenue Procedure 2015-28, 2015-16 I.R.B. 920 (April 3, 2015) (“Rev. Proc. 2015-28”). Revenue Procedure 2016-51, 2016-42 I.R.B. 466 (October 17, 2016) (“Rev. Proc. 2016-51”) modified and superseded Rev. Proc. 2013-12, Rev. Proc. 2015-27 and Rev. Proc. 2015-28.

- B. Risk of Defect. It is the Service’s position that any defect in a plan’s adherence to the requirements of section 401(a) of the Internal Revenue Code of 1986, as amended (“**Code**”), no matter how minor, can be the basis for disqualifying a retirement plan. *See* Internal Revenue Manual (“**IRM**”) 7(10)54.660(1), (2). “As a technical matter, claims that a plan is qualified . . . simply because operational violations are insubstantial, de minimis in amount, or resulted in ‘no harm’ have no legal merit. Such a plan is nonqualified” Administrative Policy Regarding Self-Correction (“APRSC”), reprinted in Tax Analysts, Daily Tax Highlights & Documents, Vol. 44, No. 5, 339 (January 8, 1997). (“APRSC Memo”).

- C. Kinds of Defects. Plan defects initially came in two general categories. Defects in a plan’s saying the right thing at the right time were typically known as form defects. Failures to operate a plan correctly were known as operational defects.

The Service then divided the operational defects category. Failing to follow the terms of a retirement plan became the only operational defect. The third type of defect to be created was a “demographic defect,” which was first identified in Revenue Procedure 94-62, 1994-1 C.B. 778 (September 8, 1994) (“Rev. Proc. 94-62”), § 4.03. A demographic defect was defined as a defect in a plan’s operation that arises from a change in employer demographics. *Id.* The Service said that failing to satisfy a nondiscrimination requirement in operation “because of a shift in the demographics of the employer’s workforce” was an example of a demographic defect. *Id.* In the context of the changes required by the Tax Reform Act of 1986 (“TRA ‘86”), the Service said that a demographic defect could include failures involving sections 401(a)(4), 401(a)(5), 401(a)(26), 401(l), 410(b), 414(q), 414(r) or 414(s) of the Code. Internal Revenue Service Field Directive dated December 14, 1994, addressing the remedial amendment period

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First appeared as part of the conference materials for the

65th Annual Taxation Conference session

"EPCRS and Retirement Plans: A Misunderstood Relationship"