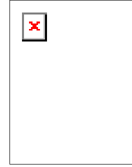
The Employee Plans Compliance Resolution System: Comments on Revenue Procedure 2001-17



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Tax Exempt and Government Entities
Internal Revenue Service, Room 6550
1111 Constitution Avenue, NW
Washington, DC 20224

Re: The Employee Plans Compliance Resolution System: Comments on Revenue Procedure 2001-17

VIA FACISIMILE: (202) 283-9598

Dear Ms. Kahn:

The American Society of Pension Actuaries (ASPPA) commends the Service on the issuance of Revenue Procedure 2001-17 (Rev. Proc.), which further updates and clarifies the guidance under the Employee Plans Compliance Resolution System (EPCRS). ASPPA appreciates that the Rev. Proc. incorporates many of ASPPA's prior suggestions.

ASPPA is a national organization of approximately 4,500 members who provide actuarial, consulting, administrative, legal and other professional services for qualified plans and Section 403(b) arrangements. ASPPA's members and their clients are committed to compliance with the legal requirements affecting these plans and arrangements. Since the Service has indicated that it plans to update EPCRS on an annual basis, and has asked for suggestions on how it might be improved, we offer the following comments.

SUMMARY OF ISSUES

This letter addresses a number of issues, which are described in greater detail below. We begin with general comments and proceed to our more specific issues, as follows:

1. Modification of VCS Procedures to Replace the Application and Filing Fee With a Notice Requirement;

2. Expansion of Procedures to Provide for Specific Time Frames for Processing VCP Applications and Expedited Processing In Certain Cases;

3. Extension of SCP Significant Correction Period to Three Years;

4. Expansion of Procedures to Provide for Voluntary Correction of Prohibited Transactions and Coordination with DOL's VFC Program;

5. Expansion of EPCRS to Include a Review and/or Appeals Procedure;

6. Expansion of Procedures to Address Restoration Payments;

7. Expansion of the Safe-Harbor Corrections under SCP to Include Reformative Plan Amendments That Meet Certain Requirements;

8. Expansion of Procedures to Include Requests for Relief from Late Filing Penalties;

9. Clarification of the Tax Treatment of Corrective Contributions and Distributions;

10. Modification of Existing Optional Methods for Determining Lost Earnings;

11. Clarification Regarding Inadvertent Contributions or Deposits to a Qualified Plan;

12. Expansion of "Factors Considered" in Determining the Amount of the Compliance Correction Fee and the Amount of the Sanction to Include Financial Hardship of the Employer;

13. Modification to the Anonymous Submission Procedure to Provide for Audit Protection;

14. Nonamenders: Modification of Procedures to Provide for Correction Through Adoption of Model Amendments, the Filing of a Notice, and Payment of a Reduced Fee;

15. Safe-Harbor Correction for Inclusion of Ineligible Employee Failure: Clarification Regarding Who the Amendment Must Cover;

16. Extension of the VCO Program to Practitioners, Such as Certified Pension Consultants, Who Are Qualified to Submit Applications Under VCP General Procedures and Represent Plan Sponsors on Audit (*e.g.,* Unenrolled Preparers);

17. Expansion of Safe-Harbor Correction Methods to Include Plan Amendment Correction for the Operational Failure of Making Plan Loans in the Absence of Specific Plan Provisions that Provide for Loans;

18. Clarification Regarding Eligibility for Anonymous Submission Procedure; and

19. Expansion of the Definition of "Transferred Assets" to Include the Case Where the Corporate Transaction Results in an Actual Change in Control of the Plan Sponsor.

DISCUSSION OF ISSUES

1. Modification of VCS Procedures to Replace the Application and Filing Fee With a Notice Requirement

The pension community has had the opportunity to work with most of the "safe-harbor" guidance and correction examples (currently described in appendices A and B of the Rev. Proc.) for a number of years. The guidance for the thirteen specified operational failures allows plan sponsors and their advisors to correct these failures without Service supervision under SCP if the plan meets the eligibility requirements for that program. For plans not meeting the SCP eligibility requirements, the failures can be corrected with Service supervision by filing an application under VCS and paying a relatively small filing fee.

Given the narrow guidelines for both eligibility and correction under VCS, and the increasing experience of the practitioner community in working with the safe-harbor guidance, it is ASPPA's opinion that there is no longer a need for a formal VCS review process. To the extent the program needs supervision to maintain its integrity, this can be adequately provided by the examination function. As a result, ASPPA proposes that the VCS application and filing requirements be replaced by the single requirement of providing notice that correction has been made in accordance with the prescribed methodology for the failure under the program. The notice would briefly summarize the information required for a VCS application (including a description of the failure and the steps taken to correct) and be attached to the Form 5500 for the year in which the correction was made.

Replacing the application (and fee) with a notice would eliminate (i) the significant cost of preparing a formal application and (ii) the time associated with the formal review process. This will make the program more attractive to employers, simplify the process, and thus necessarily promote voluntary compliance. In addition, it will allow the Service to devote its limited resources elsewhere, such as the VCO program where supervision is more crucial to ensure proper correction under EPCRS.

2. Expansion of Procedures to Provide for Specific Time Frames for Processing VCP Applications and Expedited Processing In Certain Cases

ASPPA is becoming increasingly concerned about the length of time it is taking to process applications under VCO and VCP general procedures. Our recent experience is that the entire process usually takes more than nine months, and too often takes between 18 months and two years. The problem is that these time frames and the attendant costs are often discouraging to plan sponsors, and thus potentially inhibit use of the remedial programs.

Plan sponsors have found a proportional relationship between the time it takes to resolve supervised VCP applications and the fees and costs that must be paid. In addition to fees, plan sponsors are often concerned that filing a VCO or VCP general procedures application will unreasonably delay the transfer of assets in a plan merger/acquisition situation or distributions in the case of a plan termination. For this reason, many plan sponsors may choose to forgo the IRS-supervised programs.

ASPPA is particularly concerned that the GUST restatement process and the development of guidance under EGTRRA may divert a significant portion of the Service's valuable resources away from EPCRS, and thus further increase VCP case processing time.

For these reasons, ASPPA encourages the Service to commit to specific, reasonable time frames for processing VCO and VCP general procedures applications from the time an application is complete. A time specificity would greatly assist professional advisors from recommending that plan sponsors make use of supervised remedial programs. In addition, the Service should make the programs more user-friendly by providing for expedited processing when warranted by the facts and circumstances of each particular case. This would include cases where significant plan transactions will be suspended pending completion of the VCP process, such as cases involving plan mergers and terminations. ASPPA also recommends committing a greater number of dedicated personnel to the supervised programs. Undoubtedly, the combination of additional personnel and greater familiarity with the programs will drastically reduce case processing time. To decrease processing time, we suggest that the Service expand the EPCRS safe-harbor corrections, since this permits eligible plans to avoid the formal application process entirely. In summary, our suggestions are aimed at standardizing the VCP process, which will necessarily reduce the burden on the Service, and thus reduce case processing time.

3. Extension of SCP Significant-Correction Period to Three Years

ASPPA recommends that the two-year self-correction period for significant operational failures under SCP be extended to three years. This is because a three-year correction period bears a logical relationship to plan years being open to audit under the statute of limitations. And, if the correction period were extended to match the statute of limitations period, plan sponsors would be encouraged to conduct self-audits of their plans for the entire statute of limitations period and self-correct the operational defects discovered during that process. This would necessarily reduce the number of Audit CAP cases, and at the same time, offer some workload relief to the Service's audit function.

In the experience of ASPPA's members, the current two-year correction period under SCP limits many plan sponsors to self-audit only the two most recent plan years. This is especially true for small plan sponsors because they often believe they cannot afford to become aware of defects, which might obligate them to incur the costs of a formal

application and pay a significant Compliance Correction Fee. Extending the significant defect self-correction period under SCP to three years would address many of these cases and encourage more extensive use of self-audits, and thus promote voluntary compliance. This in turn would relieve some of the burden on the Service's audit and Audit CAP functions.

4. Expansion of Procedures to Provide for Voluntary Correction of Prohibited Transactions and Coordination with DOL's VFC Program

It is ASPPA's understanding that the Service is currently exploring the possibility of expanding EPCRS to include a procedure for the voluntary correction of prohibited transactions (PTs). ASPPA believes that the procedure, to be truly effective, would have to include coordination with the Department of Labor (DOL). We strongly support such a procedure.

At one time, many of our members who practice in the Pacific Coast Area were able to assist their clients in resolving PTs by voluntarily submitting them under the prior Delegation Order 97 (DO 97) program. That program required complete correction of the PT. The correction was memorialized in a closing agreement, which also indicated that the related penalties, interest and Form 5330 filing requirements were waived. In exchange for the agreement, the plan sponsor, or a responsible fiduciary, paid a sanction to the Service equal to 75% of the excise taxes that would have otherwise been due.

Without question, the DO 97 program was enormously effective in encouraging voluntary correction in cases where prohibited transaction problems would have otherwise gone unaddressed. From our members' perspective, the main problem with the program prior to DO 97 was that the fixed sanction percentage resulted in a penalty amount that discouraged plan sponsors from taking advantage of the program. Therefore, we urge that any voluntary program for resolving PTs be structured to encourage compliance through limited fees, which could be negotiated by taking into account the facts and circumstances of each particular case.

In addition, we suggest that fiduciary breaches resolved under the DOL's Voluntary Fiduciary Correction (VFC) Program, which are also PTs under Code Section 4975, be "deemed" corrected for calculating the related excise taxes. Therefore, the taxable period for excise taxes should end no later than the VFC correction date. In the rare cases where Title II of ERISA requires correction different from VFC, such correction-if made within a reasonable period of time measured from the date of the DOL's "no action" letter-should not result in any extension of the taxable period under the excise tax provisions. ASPPA believes that coordination with DOL will provide an incentive to correct PTs on a voluntary basis, which will undoubtedly be well worth any efforts necessary in this regard.

5. Expansion of EPCRS to Include a Review and/or Appeals Procedure

As currently described in Rev. Proc. 2001-17, EPCRS appears to be based on the assumption that revenue agents will consistently and correctly apply the relevant procedures and standards in every case. However, the reality is that from time-to-time revenue agents will apply EPCRS inconsistently or incorrectly. In cases where revenue agents miss-apply EPCRS, there exists a potential for unjustified and material effects on qualified plans, plan sponsors, and participants.

For example, if a plan is under audit and the revenue agent incorrectly determines that an operational failure is egregious, the plan sponsor loses the ability to resolve that failure under SCP, and therefore, must negotiate the payment of a sanction under Audit CAP to keep the plan qualified. A similar example is where a revenue agent incorrectly determines that an operational failure is significant, rather than insignificant. Unless the failure was properly corrected by the last day of the second plan year following the plan year for which the failure occurred (or the correction was substantially completed as of the date the plan came under audit), the plan sponsor must again negotiate and pay a sanction under Audit

CAP rather than utilize SCP to maintain the plan's qualified status. Another example involves the misapplication of EPCRS when a revenue agent (or possibly the VCP general procedures coordinator) fails to consider or give the proper weight to relevant factors in determining an appropriate sanction under Audit CAP, thus increasing the amount that the plan sponsor is required to pay to secure an agreement. A final example is a VCP general procedures case where, based on the facts and circumstances of the case, a revenue agent (or the program coordinator) unreasonably rejects a plan sponsor's request to correct an operational failure by retroactively amending the plan to conform its terms to its prior operation.

For EPCRS to be truly effective, it must be administered on a consistent and uniform basis, and its procedures must be applied properly. For these reasons, ASPPA suggests that the Service establish a formal review or appeals procedure to ensure consistency and uniformity in the application of EPCRS, and to resolve differences between plan sponsors and TE/GE personnel concerning various correction programs and procedures.

6. Expansion of Procedures to Address Restoration Payments

To avoid the costly and time-consuming process of obtaining a Private Letter Ruling, ASPPA continues to encourage the Service to expand the EPCRS procedures to specifically address the issue of whether a payment into a qualified plan by an employer is a restoration payment or a contribution. This issue arises when a plan sponsor makes a payment to a plan in order to address actual or threatened litigation, and the payment is allocated to participant accounts on a basis other than as required by the plan's written terms for contributions. The failure to allocate a payment in accordance with the plan's terms is an operational failure, unless the payment into the plan is a restoration payment. For this reason, plan sponsors need a reliable and efficient procedure to determine whether an employer payment qualifies as a restoration payment.

Accordingly, ASPPA proposes that EPCRS be expanded to address the issue of whether an employer payment constitutes a restoration payment or a contribution. This could be accomplished through a notice or certification procedure in which the plan sponsor describes the purpose of the employer payment, the manner in which it was allocated to participant accounts, and how it meets established guidelines for restoration payments. The notice or certification could either be attached to an information report (*e.g.,* a Form 5500) or simply kept available in the plan's records in the event the Service later examines the plan.

7. Expansion of the Safe-Harbor Corrections under SCP to Include Reformative Plan Amendments That Meet Certain Requirements

ASPPA's members frequently encounter plans that are operated in accordance with the plan sponsor's intent and the plan participants' understanding, but contrary to the plan's written terms. This most often occurs due to a scrivener's error; however, due to an error in preparing the plan document, the plan's written terms fail to reflect the intent of all parties concerned and the plan's actual operation.

In such cases, ASPPA proposes that SCP be expanded to specifically recognize these types of errors and permit correction of the resulting operational failure through a retroactive amendment that conforms the plan's terms to its operation. The retroactive amendment should be deemed reasonable and appropriate if the plan sponsor certifies that the following conditions exist:

(a) The retroactive amendment conforms the plan's written terms to the plan sponsor's original intent and the plan participants' understanding of how the plan is to operate;

(b) After adoption of the retroactive amendment, all plan benefits, rights or features will be (or will remain) available on a nondiscriminatory basis as

required under Code Section 401(a)(4) and the regulations thereunder; and

(c) Re-administration of the plan in accordance with its erroneous written terms will be burdensome or otherwise have an adverse effect on the plan sponsor and participants.

As with the other plan amendment corrections now permitted under SCP, the plan sponsor would be required to submit the amendment for a favorable determination letter.

ASPPA believes that providing a procedure for self-correcting these types of routine operational failures will conserve the Service's valuable resources. At the same time, the procedure encourages voluntary compliance because it is a low-cost and effective means for resolving minor deficiencies in plan documentation.

8. Expansion of Procedures to Include Requests for Relief from Late Filing Penalties

Applications under EPCRS often involve cases where the plan sponsor will separately request (*i.e.,* outside of EPCRS) the Service and the DOL to waive penalties associated with the late filing of certain information reports and/or tax reporting forms, such as Form 5500. ASPPA believes that if EPCRS were expanded to permit the inclusion and resolution of late filing matters, it would result in (i) a greater degree of voluntary compliance, (ii) cost savings to the plan sponsor and the government, and (iii) a significant reduction in the time required to resolve all matters. This is because "one-stop-shopping" is significantly less complicated and time-consuming than preparing multiple applications to two government agencies; therefore, it would be an attractive and cost effective package to "sell" to plan sponsors, and as such, would promote the Service's overall goal of achieving a high level of voluntary compliance.

9. Clarification of the Tax Treatment of Corrective Contributions and Distributions

Currently, the Rev. Proc. does not sufficiently address the tax treatment of corrective contributions and distributions made under EPCRS. ASPPA believes guidance in this area is essential because many plan sponsors are making corrective contributions and distributions without a clear understanding of the proper tax treatment of these corrections. Particular issues which deserve guidance or clarification include the following:

(a) Confirmation that the portion of a corrective payment to a plan which is intended to make up for lost earnings, is not an "annual addition" under Code Sections 404 and 415 and that such a payment is deductible under Code Section 162.

(b) Confirmation that any corrective contribution and resulting allocations to participants' accounts are deductible by the employer in the year of the actual corrective contribution and that such a corrective contribution will not be treated as an annual addition for the year of the actual corrective contribution.

(c) Clarification of the tax treatment of amounts HCEs are permitted to currently defer into a 401(k) plan to correct previously distributed excess contributions that were due to incorrect ADP/ACP testing.

10. Modification of Existing Optional Methods for Determining Lost Earnings

ASPPA commends the Service for providing practical alternatives for determining earnings adjustments under plans that permit directed investments. Although ASPPA appreciates the convenience of the ability to use "the highest rate earned in the plan" pursuant to Rev. Proc. Section 6.02(5)(a), ASPPA believes that the Service should place a cap on the rate of earnings credited to a participant's account when using this method. In light of the broad availability of investment funds in many plans and the extraordinarily high rates of return on

certain funds, ASPPA believes that crediting "the highest rate earned in the plan" provides a windfall to certain participants while it can, and does, discourage some sponsors from making any correction at all. For example, one of our members determined that the highest rate earned for a client's plan was 3000% over a two-year period. ASPPA suggests that this rule be modified to place some reasonable cap (*e.g.,* a rate equal to the underpayment rate defined in Section 6621(a)(2) of the Internal Revenue Code) on this widely used method of determining lost earnings. Such a cap would provide more realistic and fair results to all plan participants.

The Service should also consider using a simpler earnings calculation method, including alternatives that do not require the sponsor or its advisors to gather inordinate amounts of detailed, up-to-the-minute, financial data. Along these lines, ASPPA suggests that defined contribution plans be given the option of calculating the rate of earnings for a plan year based upon a reasonable estimate of the rate of earnings for the previous plan year. And, if that is not reasonable under the facts and circumstances of the particular case, the plan would have the option of using the greatest of several broad market index rates (*e.g.,* the S&P 500, Lehman Brothers Bond Index or the 10-Year Treasury return rate).

11. Clarification Regarding Inadvertent Contributions or Deposits to a Qualified Plan

ASPPA's members continue to encounter situations where, for a variety of reasons, too much money has either been contributed or deposited into a qualified plan. For example, the plan administrator or the plan's institutional trustee, due to a lack of communication, inadvertently withheld (and deposited into the plan's trust) an additional participant loan payment amount, even though the loan was repaid. Another example is where the 401(k) plan sponsor mistakenly withheld salary deferrals from a participant's payroll, even though the participant requested a change or cessation of the deferral amount. In other cases, due to simple miscommunications regarding employee census information and/or arithmetic errors, a plan sponsor inadvertently contributed more than the plan's benefit formula allows.

Based upon our members' understanding of the rules regarding the return of plan assets on account of reversion, failure to initially qualify or mistake of fact, ASPPA recommends that the Service clarify the ability of sponsors to correct inadvertent contributions or deposits under SCP. If the Service believes that these types of problems cannot be-or should not be-corrected under SCP, it should provide further guidance. Finally, the Service should specifically comment on how to properly address the issue of earnings on inadvertent contributions or deposits.

12. Expansion of "Factors Considered" in Determining the Amount of the Compliance Correction Fee and the Amount of the Sanction to Include Financial Hardship of the Employer

Depending on the facts and circumstances of a particular case, resolving qualification failures under VCP general procedures or Audit CAP can be very expensive. This is because, in addition to the costs of (i) retroactive and prospective correction, (ii) possible changes to the plan's administrative procedures and (iii) professional advice in effecting the correction and/or administrative changes, the plan must pay a compliance correction fee or sanction which can, in many cases, be substantial. For an employer suffering from severe financial distress, paying even the presumptive amount on the Compliance Correction Fee chart, or a low percentage of the maximum payment amount (MPA), can be overly burdensome and potentially make correction impossible. Thus, financial hardship can be a very real impediment to the most basic of the principles underlying EPCRS, which is to further compliance.

Under EPCRS, the Service has indicated that the amount of the VCP general procedures fee and the sanction under Audit CAP should bear a reasonable relationship to the "nature, extent, and severity of the failure." Furthermore, under Audit CAP, the Service has stated that the amount of the sanction should not be "excessive." To facilitate these concerns,

EPCRS specifically provides for a number of non-exclusive factors to be taken into account by revenue agents in determining the amount of the fee or sanction. This list not only fails to address the circumstance of hardship, but makes it less likely that hardship will be taken into account. This is because the list focuses only on factors relating directly to the failure, and not the circumstances of the employer-and it is the employer which almost always bears the responsibility for funding the correction, including the fee or sanction. Furthermore, it is the experience of many of ASPPA's members that, although the list is clearly not exclusive, revenue agents are reluctant to consider other factors. For this reason-and because financial distress can make correction impossible, and thus frustrate a basic principle underlying EPCRS-we urge the Service to specifically provide that financial hardship of the employer is a factor to be taken into account in determining fees and sanctions.

13. Modification to the Anonymous Submission Procedure to Provide for Audit Protection

Section 10.12(2) of Rev. Proc. 2001-17 states as follows:

...until the plan and plan sponsor are identified to the Service, a submission under this subsection does not preclude or impede an examination of the Plan Sponsor or its plan(s). Thus, a plan submitted under the Anonymous Submission Procedure that comes Under Examination prior to the date the plan and Plan Sponsor identifying materials are received by the Service will no longer be eligible for either the Anonymous Submission Procedure or VCP.

The Pacific Coast Area program has provided a limited form of audit protection to anonymous submissions for a number of years. This program has been well run and is highly effective in promoting voluntary compliance.

Under the Pacific Coast Area "John Doe" program in effect prior to issuance of the Rev. Proc., employers and practitioners were permitted to submit "sanitized" applications and receive tentative approval regarding eligibility and correction, and limited information regarding a range of fees within which the compliance correction fee is likely to fall. Of course, any obligation on the part of the Pacific Coast Area program coordinators to abide by the "terms" of the tentative approval and estimation of fees was contingent on the submission of a complete and "unsanitized" application, and verification of all prior and current information provided. So long as the anonymous submission met the relevant application requirements under EPCRS-except for information disclosing the identity of the plan sponsor and the participants-the Pacific Coast Area would generally provide that the plan could not be examined while the submission was properly pending.

In the experience of ASPPA's members, the ability of plan sponsors to "test the waters" on an anonymous basis is an extremely strong inducement to confront and deal with actual and potential qualification failures. When the anonymous procedure is coupled with audit protection, our members see a significant increase in the number of plan sponsors who willingly face plan defects sooner rather than later. Whatever the arguments are against extending audit protection to anonymous submissions, they can be adequately addressed by appropriate application requirements and by putting time constraints on how long an application can remain anonymous once the Service and the plan sponsor have reached an agreement concerning the submission. For these reasons, we urge the Service to modify the Anonymous Submission Procedure to include audit protection.

14. Nonamenders: Modification of Procedures to Provide for Correction Through Adoption of Model Amendments, the Filing of a Notice, and Payment of a Reduced Fee

In an effort to address significant delays in the processing of nonamender applications under VCP general procedures and to relieve some of the burden on the Service resulting from the steady receipt of such applications, ASPPA suggests specifically modifying the

procedures for Community Renewal Tax Relief Act of 2000 ("CRA 2000") nonamenders.

With the remedial amendment period ending soon for calendar year individually designed plans, ASPPA is anticipating that there will be numerous instances of CRA 2000 nonamenders. Since this defect is relatively minor and can be corrected by simply adopting a model amendment, the corrective process does not appear to warrant any particular supervision and more than a minimal sanction. Accordingly, ASPPA proposes that EPCRS be modified to provide for a notice procedure for CRA 2000 nonamenders, in lieu of a formal application. The notice procedure would be available if the nonamender defect is being corrected though the retroactive adoption of a model amendment. In addition, the plan sponsor would attach a check to the notice to pay the compliance correction fee, which should be similar to the amount imposed for UCA or OBRA '93 nonamenders.

The correction procedure proposed for CRA 2000 nonamenders is consistent with ASPPA's belief that, under EPCRS, the Service should treat minor, routine defects appropriately and in a manner that conserves the government's resources and expedites processing.

We also urge that a simplified process be adopted-at least on a short-term basis-for plans that make use of new limits and other provisions of EGTRRA, but fail to timely adopt the appropriate sample amendments. To improve prompt correction, this process could be made available only for the first plan year in which the failure occurs.

15. Safe-Harbor Correction for Inclusion of Ineligible Employee Failure: Clarification Regarding Who the Amendment Must Cover

The Rev. Proc. adds a new safe-harbor correction method and example for the operational failure of including, in a qualified plan, an employee who has not completed the plan's minimum age or service requirements; the Rev. Proc. refers to this failure as the "Inclusion of Ineligible Employee Failure." The safe-harbor correction is to retroactively amend the plan to change the eligibility provisions to provide for the inclusion of the ineligible employee in accordance with the plan's actual operation. This correction is available only if (i) the amendment satisfies Code Section 401(a) at the time adopted; (ii) the amendment would have satisfied Section 401(a) had it been adopted when effective; and (iii) the employees affected by the amendment are "predominantly" non-highly compensated employees. Who should the retroactive amendment have to cover? That is, can the plan be amended to include some, but not all, of the previously ineligible employees?

Please consider the following two examples, which illustrate our uncertainty regarding how to use this safe-harbor correction method.

> **Example No. 1**. Suppose the employer had 20 ineligible employees during the relevant period, 10 of which participated earlier than the time permitted under the plan's eligibility requirements. Could the retroactive amendment be drafted to include only the 10 who actually participated and not the 10 ineligible employees? (Clearly, this would be permitted only if the plan continued to pass the coverage and nondiscrimination requirements of the Code.) If the amendment must cover all 20 employees, the employer would have to make a contribution for the 10 previously ineligible employees who did not participate early.
>
> **Example No. 2**. Assume 15 ineligible employees participated early, six of which are highly compensated employees (HCEs). Would the retroactive amendment have to cover all 15 ineligible employees? Or could it be drafted to cover seven of the non-highly compensated employees (NHCEs) and three of the HCEs, with correction for the remaining five employees handled under a non-safe-harbor approach? (Note that this still meets the requirement that the retroactive amendment affect "predominantly" NHCEs.)

The answers here are not clear. Certain IRS officials have suggested to us informally that the amendment need not cover all of the ineligible employees, so long as the plan-as retroactively amended-meets the requirements of the Code and benefits predominantly NHCEs. However, at least one IRS official has recently commented that the amendment must apply to all of the affected employees, which presumably means that in both of the examples above, all ineligible employees would have to be given retroactive participation in the plan and that the sponsor would need to make contributions for those employees who did not participate early.

The addition of a safe-harbor correction method for the common operational failure of including an ineligible employee in a qualified plan is a welcome change to EPCRS, and one that has been requested by ASPPA and the pension community as a whole since the safe-harbor correction methods were first introduced. To facilitate the use of this correction method, we request that the IRS provide further clarification regarding who the corrective amendment must cover.

16. Extension of the VCO Program to Practitioners, Such as Certified Pension Consultants, Who Are Qualified to Submit Applications Under VCP General Procedures and Represent Plan Sponsors on Audit (*e.g.,* Unenrolled Preparers)

ASPPA continues to support the acceptance of VCO applications submitted by Certified Pension Consultants and other professionals who are qualified to advise plan sponsors about the VCO program. These are practitioners who are authorized to represent their clients in an IRS audit or to submit a case under VCP general procedures, but are considered unenrolled preparers for purposes of Form 2848. ASPPA believes that extending the VCO program to these individuals will increase the support and use of VCO, and thus promote voluntary compliance.

17. Expansion of Safe-Harbor Correction Methods to Include Plan Amendment Correction for the Operational Failure of Making Plan Loans in the Absence of Specific Plan Provisions that Provide for Loans

Our members encounter plans in which participant loans have been made; however, the plan fails to specifically provide for them. Therefore, making the loan result in a failure to operate the plan in accordance with its terms, and is thus an operational failure. (Of course, if the loan is to a disqualified person, it also results in a prohibited transaction.)

If the loan would have satisfied the qualification requirements had the plan specifically provided for loans at the time the loan was made, then the VCP and SCP correction should be to retroactively amend the plan to provide for the loan(s) made. Of course, any such amendment would have to comply with Code Section 401(a) as of its effective date. Any resulting prohibited transaction could be resolved under the voluntary procedure described in item 4 above. This situation is similar to that covered by Section 2.07(2) of Appendix B to the Rev. Proc., regarding the plan amendment correction for "Hardship Distribution Failures." We urge that it be given similar treatment.

18. Clarification Regarding Eligibility for Anonymous Submission Procedure

With respect to the Anonymous Submission Procedure, Section 12.12 of the Rev. Proc. states "[o]nly failures other than those addressed in Appendix A and Appendix B of [the Rev. Proc.] may be submitted under this procedure." This appears to indicate that if the failure is one of those specified in the appendices, even if a safe-harbor correction is not proposed, the failure is ineligible for resolution under the Anonymous Submission Procedure. ASPPA believes that this is not what the Service intended.

Consider the following example:

> *Facts*. Companies A, B, and C are all members of a controlled group of corporations. Company A adopts a standardized prototype 401(k) plan from

an investment provider. Companies B and C each adopt similar plans. The document provides the typical boilerplate, controlled group language requiring immediate coverage and participation for all eligible employees of a "related" employer. Companies A, B, and C are completely unaware of this provision and that it requires Company A's plan, for example, to provide immediate participation for all eligible employees of the controlled group. It was always the intent of all members of the controlled group that each of the companies would sponsor a 401(k) plan for its employees only. And, in fact, each of the plans standing alone satisfies coverage and nondiscrimination testing.

Defect. In operation, Company A's plan did not cover eligible employees of Companies B and C, as required under its terms. Therefore, Company A's plan incurred the operational failure of excluding eligible employees as described in Section 2.02 of Appendix B of the Rev. Proc.

Proposed Method of Correction. Although the failure is one which is described in Appendix B of Rev. Proc. 2001-17, Company A proposes a non-safe-harbor method of correction, which is to retroactively amend the plan to eliminate the coverage requirement for employees of related companies. Such correction may be permitted in accordance with Section 4.06(2) of the Rev. Proc. Among other things, Company A argues that the retroactive amendment is appropriate in this case because (i) it complies with Code Section 401(a), (ii) it would not cause the plan to discriminate in favor of highly compensated employees, (iii) it conforms the plan document to the original intent of all the parties, and (iv) the employees of Companies B and C are already covered by plans sponsored by B and C.

Although the failure described above is addressed in Appendix B of the Rev. Proc., the proposed correction is not. Instead, the proposed correction relies on a facts and circumstances argument based on Section 4.06(2) of the Rev. Proc. ASPPA believes that it is not appropriate for this type of case to be precluded from the Anonymous Submission Procedure; however, the language of Section 12.12 of the Rev. Proc. indicates that this is the case. We urge that this be clarified.

19. Expansion of the Definition of "Transferred Assets" to Include the Case Where the Corporate Transaction Results in an Actual Change in Control of the Plan Sponsor

It appears that the definition of "Transferred Assets" in Section 5.01(8) of the Rev. Proc. is not applicable to the situation where one company purchases another company which sponsors a qualified plan, and as a result, the acquiring company now actively maintains the plan. For example, Company A acquires Company B, which sponsors a qualified plan. As a result of the transaction, Company A now maintains the Company B plan. After the acquisition, Company A discovers an operational failure in the Company B plan. It appears that the plan is not entitled to the extended self-correction period described in Section 9.02 (2) of the Rev. Proc., even if Company A has actively taken over sponsorship of the plan.

The purpose of the extended self-correction period appears to be to provide some relief in situations where an acquiring company may not have had adequate time to conduct in-depth due diligence reviews of a plan before taking over control and responsibility for the plan's assets. If so, then it appears the extended correction period should apply to any transaction resulting in an actual change in plan sponsorship. Accordingly, ASPPA encourages the Service to consider expanding the definition of "Transferred Assets" to include the situation where a business transaction results in a true change in plan sponsorship.

Our members have a considerable amount of experience with EPCRS, and ASPPA believes that EPCRS is a very worthwhile system. However, ASPPA agrees with the

Service that there are ways in which EPCRS can be improved to make it more accessible and efficient to plan sponsors.

The comments in this letter were prepared by Nick White and the members of the ASPPA IRS subcommittee, chaired by Jeffrey C. Chang, with the assistance of the 401(k) Plans subcommittee, Reporting and Disclosure subcommittee, and Government Affairs Committee co-chairs and Administration Relations chair.

Please contact us if you have any comments or questions regarding the matters discussed in this letter.

Sincerely,

Jeffrey C. Chang, Esq., APM, Chair IRS Subcommittee	Brian Graff, Esq. Executive Director
Bruce Ashton, Esq., APM, Co-Chair Government Affairs Committee	R. Bradford Huss, Esq., APM, Co-Chair Government Affairs Committee
Theresa Lensander, CPC, QPA, Chair Administration Relations Committee and Chair	

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