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## 401(k) Plan Corrections Programs

### *An Overview*

Because of the significant ramifications of plan disqualification, it is in the best interest of plan sponsors and participants for qualified plans to retain their qualified status. The Department of Labor (DOL) and the IRS have correction programs available to help 401(k) plan sponsors correct plan defects, protect plan participants and maintain tax benefits for the plan and its participants. These programs are structured to encourage plan sponsors to voluntarily keep their plans in compliance.

The IRS sponsors the Employee Plans Compliance Resolution System (EPCRS) for correction of plan qualification failures, including:

- Plan Document Failure – failure to include required provisions, or the inclusion of a provision that violates qualification rules;
- Operational Failure – failure to follow the terms of the plan; and
- Demographic Failure – failure to meet/correct coverage and nondiscrimination requirements.

There are, of course, other types of actions that have tax or penalty consequences under qualified plan rules. These include actions that fall under Department of Labor oversight. The DOL generally oversees the fiduciary responsibility, prohibited transaction, and reporting and disclosure requirements of the Employee Retirement Income Security Act (ERISA). The DOL sponsors a correction program for delinquent filing of annual reports, and another for correction of specific financial transactions that violate ERISA, such as delinquent participant contributions.

### **Employee Plans Compliance Resolution System**

Under EPCRS there are three methods by which errors may be corrected. Under each of these methods, the plan sponsor agrees to make correction of the error and the IRS agrees not to disqualify the plan because of the error.

#### **Self Correction Program – A Way to Correct Errors without IRS Involvement**

Under the Self Correction Program (SCP), certain operational failures can be corrected without IRS involvement. No notification to the IRS is required and no fees or penalties are paid to the IRS. SCP is the formalization of what many plan sponsors would do anyway – fix a problem when one is discovered and place participants in the position they would have been in if no problem had occurred. To be eligible for SCP, the operational failure must be either (i) an insignificant failure, or (ii) a significant failure that is corrected within two years of the year in which it occurred. Whether a violation is insignificant or significant is based on an analysis of all facts and circumstances (e.g., percentage of assets or number of participants involved). Of course, plan sponsors can always ask the IRS to verify the method of correction via the VCP program described below.

#### **Voluntary Correction Program – When Errors Cannot be Corrected via the “Do-it-Yourself” program**

The Voluntary Correction Program (VCP) is available for plan errors that are not eligible for self-correction under SCP. All types of qualification failures can be resolved through VCP: plan document failures, operational failures, and demographic failures. Under VCP, plan sponsors notify the IRS of errors via a formal submission package and pay a fee to the IRS based on the total number of plan participants. Relief under VCP is in the form of a compliance statement from the IRS that addresses the failures identified during submission, the terms of correction (including any revision of administrative procedures), and the time period within which corrections must be made. Fees are generally determined in accordance with the chart below, but in virtually all cases, the fee is equal to only a small fraction of the amount of tax benefit preserved. Lower penalties may be imposed under certain circumstances.

Number of Participants	VCP Fee
20 or fewer	\$ 750
21 – 50	\$1,000
51 – 100	\$2,500
101 – 500	\$5,000
501 – 1,000	\$8,000
1,001 – 5,000	\$15,000
5,001 – 10,000	\$20,000
10,000 +	\$25,000

### **Audit Closing Agreement Program – When IRS Audits Your Plan**

Audit Closing Agreement Program (Audit CAP) arises when qualification failures are found during an examination of the plan by the IRS. To obtain relief under Audit CAP, the employer must agree to correct the violation, pay a sanction, and sign a closing agreement with the IRS. The closing agreement is binding on the IRS and the plan sponsor with respect to tax matters and periods specified in the agreement. The sanction charged to a plan sponsor is negotiated under Audit CAP, but is always less than the impact of the plan losing its tax benefits through disqualification. Sanctions are intended to bear a reasonable relationship to the nature, extent, and severity of the failure, taking into account the extent to which correction occurs before audit.

### **Delinquent Filer Voluntary Compliance Program**

The DOL sponsors the Delinquent Filer Voluntary Compliance Program (DFVCP) to encourage plan sponsors to voluntarily comply with the annual reporting requirements under ERISA. The DFVCP is available for plan sponsors who have not been notified by the DOL of a failure to timely file an annual report and provides sponsors a way to avoid higher civil penalties assessed for late or missed filing of the Form 5500 Series Annual Return/Report.

Under the program, the plan sponsor files a complete Form 5500 with the DOL for each year relief is requested. Then, a second copy of the Form 5500 is submitted to the DFVCP with the applicable penalty amount. Penalties are generally \$10 per day for late filings, with a “per filing” cap of \$750 for small plans (< 100 participants) and \$2,000 for large plans. A per plan cap of \$1,500 for small plans and \$4,000 for large plans is available for sponsors who have failed to file an annual report for multiple plan years. Penalties under the DFVCP cannot be paid from plan assets.

### **Voluntary Fiduciary Correction Program**

The DOL’s Voluntary Fiduciary Correction Program (VFCP) is designed to encourage plan sponsors and fiduciaries to voluntarily comply with ERISA by self-correcting certain violations of the law and applying for relief from enforcement actions. Certain VFCP violations are also eligible for relief from payment of excise taxes. Specific categories of transactions are covered under VFCP, and the program describes acceptable methods for correcting violations. Persons using VFCP must fully and accurately correct violations by taking the following steps:

- Identify any violation and determine whether they fall within the transactions covered by VFCP;
- Follow the process for correcting specific violations (e.g., late participant contributions, improper loans, or improper payment of expenses by plan);
- Calculate and restore any losses or profits with interest, if applicable, and distribute any supplemental benefits to participants; and
- File an application with the appropriate DOL regional office that includes supporting documentation showing evidence of corrective action taken.