

April 1, 2013

IRS Compliance Sale: The Time to Correct §403(b) Plan Document Failures Is Now!

The updated Employee Plans Compliance Resolution System (EPCRS) went into effect April 1. (See [January 4, 2013, Day Pitney alert](#) describing this update.) EPCRS, which provides procedures for employers sponsoring retirement plans to correct certain plan errors, now provides employers the opportunity to fix incomplete or inaccurate §403(b) plan documents (known as "Plan Document Failures") by making a voluntary submission to the IRS. If the submission is made **on or before December 31, 2013**, employers may pay a **significantly reduced compliance fee**. **What Is a §403(b) Plan Document Failure?** Effective January 1, 2009, all employers sponsoring §403(b) plans were required to adopt a written plan document containing specific terms required under the Internal Revenue Code. This requirement was generally met if the employer adopted the written §403(b) plan document no later than December 31, 2009. Although the rules governing §403(b) plans do not define what it means to "adopt" a plan, the requirement is typically satisfied if the written document is adopted in accordance with the employer's governing procedures, e.g., bylaws, and the plan document is signed by a duly authorized person. If on IRS audit, an entity is unable to produce evidence that it properly adopted the written plan document by December 31, 2009, it may have a Plan Document Failure, even if the document contains all the required terms. A Plan Document Failure could result in the §403(b) plan losing its tax-favored status, meaning the employees' ability to accumulate retirement savings is reduced and their current income tax liability increased. **Which Employers Are Likely to Experience a §403(b) Plan Document Failure?** Section §403(b) plans can be maintained only for the benefit of employees of private §501(c)(3) organizations, such as religious, charitable and educational organizations, and for the benefit of employees of public schools. While any employer is vulnerable to a Plan Document Failure, §403(b) plans maintained by a governmental entity or by an employer whose plan allowed for only voluntary employee contributions were not generally subject to the written plan document requirement prior to 2009. These employers should examine their records to be sure their documents are now compliant. **What Are the Financial Savings for Correcting §403(b) Plan Document Failures Now?** If the voluntary submission is limited to the failure to timely adopt the §403(b) plan document, the applicable IRS compliance fee **is reduced by 50 percent**, provided the submission is made **on or before December 31, 2013**. For example, if a §403(b) plan has between 101 and 500 participants, the compliance fee for 2013 is **\$2,500 rather than \$5,000**. Clearly this \$2,500 is a bargain when contrasted with the potential financial exposure for not correcting the Plan Document Failure in 2013. First, if the voluntary submission is made after 2013, the compliance fee will double in amount. Second, if not corrected under EPCRS, the Plan Document Failure could cause the employer to pay a negotiated sanction amount far in excess of \$2,500. As noted above, a Plan Document Failure causes the §403(b) plan to lose its tax-favored status. Instead of imposing this draconian penalty, in reality, the IRS negotiates a sanction amount based on the additional income tax the IRS could collect for all open tax years from the individuals participating in the §403(b) plan. To illustrate the potential sanction, look at just one participant who contributes an average of \$16,000 per year and who pays an effective federal tax rate of 25 percent. The starting point for the sanction amount with respect to just this one participant is \$12,000. Obviously this amount increases dramatically when all participants are considered. Although the IRS negotiates a percentage of the maximum sanction

amount, it does not typically reduce the sanction below the amount the employer would have paid under EPCRS if it submitted voluntarily. **How Can Day Pitney Help?** Day Pitney's Employee Benefits and Executive Compensation practice group has deep experience with EPCRS. In connection with the above, our attorneys can:

- Review §403(b) plan documents to determine if they contain the specific terms required by the Internal Revenue Code.
- Review the procedures for adopting the §403(b) plan to determine if the plan was timely adopted.
- If necessary, prepare the voluntary submission under EPCRS and represent the employer in any negotiations with the IRS.