The New 403(b) EPCRS Rules: It's Complicated...
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Be prepared to work hard when you need to take a 403(b) plan through the new EPCRS process under Rev Proc 2013-12—as many of you will need to do soon—especially if you have to use the VCP process, or are defending an audit under CAP. It is going to be complicated. Quite frankly, a separate 403(b) guide to the VCP program will need to be utilized.

This is not necessarily the fault of the drafters of the Rev Proc. They were stuck with a very difficult task: to try to make something which is fundamentally different from a 401(a) plan still fit uniformly into the 401(a) correction scheme. It is clear that a great deal of effort went into this task, but it is still, in many respects, trying to fit round pegs into square holes. To do so requires a number of tortured acts.

This will come out when we actually try to apply the details of the corrections programs in practice. Sometimes it will work and, well, sometimes it is not going to. But in all events, you will need to think it through thoroughly, and outside of the 401(a) box to which one is normally accustomed.

Hopefully, a few tips will be useful to this effort:

Late/non-adopters. The IRS put together a sound program for dealing with "late adopters" and "non-adopters" of 403(b) plan documents. The 2007 regulations imposed a plan document requirement on 403(b) plans, requiring at first that they be adopted by 12/31/2008. The IRS granted an extension until 12/31/2009, as long as certain requirements were met.

Sponsors who adopted a plan document after 12/31/2009 (or failed to meet the requirements for the extension until that date), or who still haven't gotten around to adopting a document, can now protect themselves from the penalties arising from the lack of a timely plan document adoption through a "late adopter" VCP submission. The IRS sought to encourage these filings by reducing the VCP fee by 50% if the filing is made by 12/31/2013. But it is still a VCP fee, which can be substantial.

The details, however, can make it difficult. The Rev Proc requires a statement that "the plan sponsor has contacted all other entities involved with the plan and has been assured of cooperation to the extent necessary to implement the applicable correction." This means contacting all of the vendors under the plan, including deselected vendors, to obtain this statement. This, again, raises the ugly issue that the plan sponsor will need to resolve: what contracts are under the plan under Rev Proc 2007-71 (assuming it applies to EPCRS, which is not entirely clear), and which are not?

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EPCRS also requires that late adopters engage in a "best efforts" compliance review, as described in the original IRS Notice 2009-3 plan document extension, as a condition to using this part of the program.

There are a number of technical twists to the VCP filing to deal with 403(b) [such as, for example, dealing with the fact that 403(b) plans do not have the required "Favorable Letter"]. The compliance letter which will be issued will recognize the plan as being adopted timely, but will not opine on the qualified status of the plan document. Which leads to the next point:

Plan document failures (other than late adopters). This one is really messy. A plan document failure is one under which a plan term itself, or the lack of a plan term, will cause the plan to fail 403(b) status. In reality, there are precious few terms that need to be in a 403(b) plan document, and of those that need to be in, there is little guidance as to what they should say. The IRS also recognizes that it generally has a problem because of the lack of a 403(b) determination letter program.

To the extent that a plan document error is found on CAP, the plan sponsor will be let off the hook as long as it agrees to adopt correcting amendments in accordance with, within the time permitted, and to the extent required by, the remedial amendment period which will be adopted by the yet to be developed determination letter programs. (I suppose there may be certain, egregious errors which won't be covered by remedial amendments, but one can only guess.)

With regard to VCP, I really have a hard time figuring out the circumstances where good faith terms would ever need to be submitted under VCP as a plan document failure until the 403(b) determination letter programs are developed. This is because those plans can always be corrected under the yet to be developed remedial amendment period. Now this will change over time, of course, to the extent a newly required document term is required by a change in the law, and it is not timely adopted.

Operational errors. The new EPCRS states that the 403(b) corrections will be applied in the same manner as the 401(a) corrections. My first response to this overly broad statement can be best described by the old Trix cereal commercial ("Silly Rabbit..."). 403(b) plans still are not 401(a) plans, and the corrections—and the ability to correct—are often quite different. So exercise caution when putting the VCP submission together.

Let's use the example of the required minimum distribution. Here's what EPCRS says: "In a defined contribution plan, the permitted correction method is to distribute the required minimum distributions (with Earnings from the date of the failure to the date of the distribution). The amount required to be distributed for each year in which the initial failure occurred should be determined by dividing the adjusted account balance on the applicable valuation date by the applicable distribution period. For this purpose, adjusted account balance means the actual account balance, determined in accordance with § 1.401(a)(9)-5, Q&A-3, reduced by the amount of the total missed minimum distributions for prior years."

Well, the problems with applying this to the 403(b) minimum distribution are many: because it is an individual, not plan, requirement, the amount of the RMD is based upon all of the 403(b) contracts of the employee with any employer in that participant's lifetime; the employee has the right to elect which contract to take the RMD from; and most individual contracts do not permit the employer to force out a distribution from the contract. To do so, by the way, may well violate certain securities laws under certain circumstances. This really means that EPCRS likely cannot be used to correct many 403(b) plans

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with RMD failures.

So, be careful.

Vendor cooperation statement. Finally, any 403(b) VCP submission requires that above noted statement that “the plan sponsor has contacted all other entities involved with the plan and has been assured of cooperation to the extent necessary to implement the applicable correction.” This means sponsors need to affirmatively contact each vendor, including deselected ones, for VCP to succeed. In addition to the problems in identifying which vendors are part of the plan, vendors themselves may have a problem. They may need to caveat that statement with “to the extent permitted by law.” State insurance law, state contract law, and certain securities laws may otherwise prevent this “cooperation.”

This actually reflects an attitude of certain Treasury staff which I find troubling: the belief that vendors have the unilateral right to change their contracts with individuals to give employers certain rights over the individual’s contract. My experience is that state law is still valid. State insurance commissioners, in particular, take a dim view of insurers and employers acting in such a fashion without the policyholder's consent.

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It will take a bit of work to implement this program, and we are likely to find everyone struggling a bit in its implementation. VCP may become unavailable in many instances to the 403(b) plan. Where this happens, I would hope that this would be a factor to be taken into account when determining sanctions for such plans should they become subject to Audit CAP.

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