Flashpoint: The IRS Provides an Opportunity to Get with the Program

On June 3, 2022, the IRS issued an edition of its Employee Benefits News ("EBN") in which it advised plan sponsors and advisors of a new pilot Pre-Examination Compliance Program. Under this program, the IRS sends a plan sponsor a letter, advising it has selected the sponsor's plan for an Employee Plans examination. Nothing new here. But what happens next is very new.

Under the pilot program, the IRS advises the plan sponsor that it has 90 days to review the plan's compliance. During the review period, if the sponsor discovers compliance issues, it can self-correct the failures (if permitted under the IRS's correction program) or affirmatively request that the IRS allow the sponsor to enter into a closing agreement on favorable terms. The IRS's stated purpose in providing this 90-day window and correction opportunity is to "reduce taxpayer burden and reduce the amount of time spent on retirement plan examinations." If it works, the IRS will consider making it a permanent part of its overall compliance strategy.

IRS Letters Are Already in the Mail

One of our third party administrator clients has already received such a letter from one of their plan sponsors (what a good girl!). The letter specifies the primary issue that the IRS is interested in reviewing (in our client's situation, Code section 415 limitations). While this gives us a particular area of focus, the IRS letter clearly notes that the sponsor should be reviewing "any other issues that exist."

When we last left off in 2019, we raised concerns for service providers regarding fraudulent distribution requests and the rise of identity theft in the retirement industry. Since that time, there have been several prominent lawsuits in the news involving retirement plan participants who have been victimized by cybertheft and found no resolution with either the plan sponsor or the service provider (Estee Lauder, Abbott Labs, etc.). What is even sadder is our Firm's frequent involvement helping clients get through the worst experience of their lives, becoming the victim themselves of identity theft.

How the New Program Works

Cooperating with the IRS Request Should Eliminate or Significantly Reduce Sanctions

Both the EBN and the actual IRS letter indicate that the IRS will use the IRS's Voluntary Compliance Program ("VCP") fee structure to determine the amount the plan sponsor will pay to

the IRS for a closing agreement. However, neither states definitively that the sanction will equal the VCP fee. In any event, it is clear that proactive correction in response to the IRS letter will provide the plan sponsor with a less expensive process than Audit CAP, the normal correction procedure when errors are discovered by an IRS examiner.

To Take Advantage of This New Process, the Plan Must Give the IRS Information that Demonstrates Either Compliance or Correction

The plan sponsor's response to the IRS should show that:

(1) the plan is fully compliant with the issue the IRS has raised;
(2) the plan was not compliant with regard to that issue, but it is being or has been corrected; and/or
(3) the plan sponsor has identified and has corrected or is proposing to correct issues other than that raised by the IRS.

Data provided by the plan sponsor should support the applicable contention as to the plan's compliance or correction. The IRS will review the information. If it agrees with the plan sponsor's assertion that the plan is compliant with the issue raised or that full and proper self-correction is possible (and has been completed or is in process), the IRS will issue a closing letter with no further contact.

If, however, the IRS disagrees with the correction method, the plan sponsor has requested a closing agreement in relation to the identified issue (i.e., self-correction is not permitted), or the plan sponsor has identified other compliance issues, the IRS will determine whether to move forward with the examination (either on a full or limited scope). Remember that any closing agreement sanction in relation to the disclosed failures should be less expensive than the normal audit sanction.

What You Need to Give the IRS in Your Response to the 90-Day Letter

The particular IRS letter that we reviewed recommends that the plan sponsor send certain items to "substantiate that your plan is qualified in form and to verify filings." These items include:

(1) a signed copy of the plan document and all amendments relating to the years under examination;
(2) participant allocation schedules, census reports, account statements, and Forms W-2 for the years under examination;
(3) administration documentation relating to the specific issue the IRS has identified (in our case, demonstrations that the plan has complied with the Code section 415 limits or, if not, that the error has been corrected); and
(4) "any other documents or explanations you believe will help in our review."

The letter notes the plan sponsor may mail or fax these items, but it also advises that the sponsor can send electronic information in "other ways" if it contacts the reviewer to discuss. Hopefully, this means that portals may be available to transmit information electronically.

If the plan sponsor has questions, a name and phone number for the person at the IRS to contact is provided.

What If You Choose Not to Respond?

If the plan sponsor does not respond during the 90-day period, the IRS will simply go forward with the normal examination process.

What Does This Mean in Practice?

In practice, a plan sponsor will have 90 days to review its plan and decide how to proceed with the IRS, with the potential of never having to engage in an IRS examination at all. A smart sponsor will use that period to review its plan and to put its best foot forward to impress the IRS with its culture of compliance.

How Do We Do That?

In our experience, most plan sponsors do not know whether their plans comply with the law. Therefore, the highest and best use of this 90-day window is to act quickly to get someone in to pre-examine the plan for issues that the IRS would discover in an audit if one were to take place, and to propose remedial action if anything untoward is found. The practitioner performing this process should have the expertise to find potential problems and the bandwidth to do the work quickly and completely.

We often recommend that clients hire independent third parties to perform a plan compliance review to determine if there are any issues to be addressed. We cannot think of a better use of this 90-day period, with the IRS knocking at your door. And, as the plan sponsor will be collecting the raw data to provide to the IRS anyway, handing it to someone else first does not represent any significant additional time or energy commitment.

No practitioner can guarantee he or she will uncover everything the IRS would find in its examination. But, a "second set of qualified eyes" on the plan will likely discover any significant issues that represent the highest risk in an IRS exam.

If the plan's TPA is going to review its own work, we recommend that the plan sponsor request that someone other than the normal servicing person in the TPA's office perform the review. Remember: the goal is for someone to look at the plan with the freshness that the IRS reviewer would bring to bear. Also, if you are the TPA, you may want to have a special engagement letter or memo to the client that outlines the breadth of your review and any liability limitations that you may want to put into place in relation to this project.

Then What?

If the pre-review shows that the plan has issues, someone with significant knowledge of plan corrections should determine the best approach with the IRS: Can we self-correct the problem? What is the best way to do that? What options do we have? What will the IRS likely approve? How do we put our best foot forward?

Knowing the approach that the IRS is likely to take and what is or is not an acceptable alternative will be key in this process. The goal is to make sure the IRS understands, in the words of Obi-Wan Kenobi (and Alison Cohen): "These are not the droids you're looking for."

Final Words …

No one knows at this time how accommodating the IRS will be and how common it will be to have no, or a VCP-level, sanction in relation to the items that discovered and disclosed during the 90-

day period. However, one can only hope the IRS is going to the effort of rolling out this pilot program to have it work to reduces everyone's pain and time.

If you receive one of these letters from the IRS and would like us to help you, please let us know. After all, we are your ERISA solution!

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