Flashpoint: Sticking It to the Little Man: Why the New IRS VCP Fees are Bad for Small Business, TPAS, and Retirement Plans

Forgive us if we don't sing the praises of the Internal Revenue Service ("IRS") for the most recent update to the Voluntary Correction Program ("VCP") fee schedule. A number of articles have been published since the release of Revenue Procedure ("Rev. Proc.") 2018-4, expressing enthusiasm about the reduction of the fees for mega-corporations that use VCP to correct errors in their retirement plans. However, as many plans are sponsored by smaller employers, and they are being harmed by the new guidance, we see nothing to praise here.

A Brief History of VCP Fees

Historically, the IRS realized that it could not possibly audit all retirement plans to ensure their compliance with Internal Revenue Code ("Code") requirements. The goal, according to the IRS, was to encourage voluntary compliance by plan sponsors. Failure to comply with Code requirements can cause a plan to lose its tax benefits, resulting in full or partial taxation of all benefits. That was the "stick" in the "carrot and the stick" analogy. The "carrot" had to be some way to make employers who monitored their own plans' compliance better off than those who didn't. The answer: an affordable, easy-to-use program that was far cheaper than the potential sanction should the error be discovered on IRS audit. The VCP Program was an element of this approach: employers who discovered their own errors could do a submission to the IRS for a palatable fee and get their plans re-koshered (so to speak). VCP user fees ran from a low of $750 for plans with 20 or fewer participants, up to a high of $25,000 for plans with 10,000 or more participants. For small plans – i.e., those with 100 or fewer participants, the VCP fee was never higher than $2,500.

In 2015, at the urging of the retirement plans community, the IRS made VCP fees even more affordable. In Rev. Proc. 2015-27, the IRS provided a special fee schedule for certain common failures. For example, a plan could correct 13 or fewer plan loan errors for a mere $300 fee. If the plan had fewer than 150 participants who failed to take their minimum required distribution ("MRD"), the total VCP user fee was reduced to $500. (And the heavens opened up and the angels started singing….)

The IRS was clear in its reasoning for the fee reduction. In Rev. Proc. 2015-27, section 3, it says, "This change is being made to provide an improved method for determining compliance

fees for large plans that have a relatively small number of loans that do not satisfy the requirements of §72(p)." Notwithstanding the stated favoring of larger plans, this user fee reduction benefitted nearly, if not every, size plan and encouraged plan sponsors to properly correct these types of failures through VCP instead of self-correcting on the sly and hoping for the best.

In 2016, the IRS released a spiffy, updated version of the Employee Plans Compliance Resolution System ("EPCRS") under Rev. 2016-51. Building off the positive feedback received from the 2015 changes, the IRS reduced the general filing fees for VCP. This again lowered the cost of VCP submissions, making them more accessible for more plan sponsors wanting to fix compliance problems. Here is how the fees changed:

# of participants	Rev. Proc. 2013-12	Rev. Proc. 2016-51
>20	$750	$500
21 – 50	$1,000	$750
51 – 100	$2,500	$1,500
101 – 500	$5,000	$5,000
501 – 1,000	$8,000	$5,000
1,001 – 5,000	$15,000	$10,000
5,001 – 10,000	$20,000	$10,000
10,000+	$25,000	$15,000

The only plans that did not benefit from these changes were those with 101 to 500 participants and their fees stayed the same. For purposes of this article, we tried to research the number of VCP filings submitted to the IRS by year, but this information is not available to the general public on the IRS website. (This is in stark contrast to the Department of Labor ("DOL") and its very public brag book that is available by year showing the statistics of every investigation, Voluntary Fiduciary Correction Program filing, and every criminal indictment.) Nonetheless, our experience was that these lower fees resulted in more willingness by employers to use the VCP solution, and increased the number of filings.

That's Not Chocolate Ice Cream Underneath the Whipped Cream…

Welcome to 2018. In the first week of January, the IRS released Rev. Procs. 2018-1 through 2018-5 in a wonderful clump of 274 pages for our reading pleasure. There was no advance warning. No fanfare. The January 2, 2018, publication was followed by an incredibly subtle Employee Plans News email on January 4. Excited pension nerds everywhere broke out their highlighters and sticky notes, flipping quickly to the fee summary page at the end of Rev. Proc. 2018-4. Page 3 of this Appendix A summarized the new VCP fee schedule and – spoiler alert – it's now based on assets, not participant count, and the minimum fee has tripled.

$500,000 or less	$1,500
Over $500,000 – $10,000,000	$3,000
Over $10,000,000	$3,500

Why the change to an asset-based schedule? No idea. There is no explanation in the Rev. Proc. and the Employee Plans newsletter was equally silent. The initial break point of $500,000 is seemingly arbitrary. In a review of all VCP submissions prepared by our firm in 2017, a whopping 86% of our clients would have been harmed by this change.

More to the point, the new fee schedule benefits large plans significantly, despite the harm it does to small employers. If you look at these fees as a percentage of assets, a plan with $100,000 in assets will pay .15% of total assets as its user fee. A plan with $1,000,000 in assets, will pay .3% of total assets as its user fee. However, our poor large plan with $100,000,000 in assets will only pay .0035% of total assets as its user fee – 100 times less than a small plan. Furthermore, to a small employer with a few employees and a plan with a little more than half a million dollars in assets, a $3,000 fee is real money. To a large company with a huge plan, $3,500 is pocket change.

How Is This Fair?

If all you looked at was Appendix A of the new Rev. Proc., you missed the subtle change that will harm small plans even more. Remember that quote earlier from 2015 about the IRS changing user fees for loan and MRD failures because it would encourage plan sponsors to properly correct? Gone! Buried in Section 2.03(4) of Rev. Proc. 2018-4, the IRS officially kills these special fees. So, if you are an employer with a single loan that needs to be corrected, you have now jumped from a $300 user fee to $1,500, at a minimum. Our review of our 2017 VCP submissions reflects that all our loan failure corrections would have escalated to $3,000. This is a 1000% increase. On the other hand, a large plan with a major qualification error recognizes a fee decrease from $15,000 (which was $25,000 before the 2015 fee increase) to $3,500 – a 429% decrease.

At the same time that the effective date for other changes the IRS made in other programs it offers to taxpayers was February 1, 2018, the new VCP fees became effective immediately as of January 2, 2018. This means that there is no opportunity to quickly finish any VCP submissions that currently are in process; every submission that was about to be dropped in the mail right after the first of the year now need to be revised (and a larger than expected fee must be paid).

This Affects Practitioners, Too

If you are a TPA, you may be thinking, “Why do I care?” You should care because the cost of any mistake you make (or your client thinks you made) just got much higher. Suppose one of your administrators drops the ball and a participant doesn’t receive his minimum required distribution on a timely basis. You want to make “good” on your mistake. What would have cost you $500 in user fees now costs you $3,000.

Slight change in facts from the above – what if it is not clear who’s at fault? Are you and your client more or less likely to argue over $3,000 than $500? Is it easier or harder for you to pay the user fee as a good will gesture to a client when the fee is six times larger than it was? Finally, if your client decides that paying $3,000 is too much (which may be likely for small employers), and they choose instead to self-correct, who is going to be sweating it out when the plan ends up getting audited?

Let's Pan Out for a Wide Shot!

We believe that it is also important to look at this latest change in perspective with all of the other changes made by the IRS in the past three years … and what appears to be clear is that there is less IRS concern with "customer service." First, the IRS took away all phone and internet access to their technical assistance. Attendance and dialogue with senior IRS officials at benefits conferences was significantly reduced, if not curtailed. So, if you have a technical question, there is no longer an available means for getting help from the IRS.

Second, the IRS announced the demise of the determination letter program for individually designed plans. While not a fatal blow for plan sponsors that use pre-approved plan documents, this increased the level of risk for plan sponsors who, for whatever reason, must use an individually drafted document.

Third, the IRS started chipping away at some of the benefits of VCP. Rev. Proc. 2016-52 changed the rules for anonymous submissions – ones that are filed without identifying the plan sponsor because the resolution of the problem (and its related cost) is not clear – so that there is no refund of half the user fee if no agreement with the IRS results, as there was in the past.

Lastly, the IRS has been working for several years on "Lean Six Sigma" – a management methodology aimed at combining functions and jobs to save money. The revamp of its computer and processing systems has caused a significant backlog of VCP submissions. Getting an IRS acknowledgement letter on a VCP submission, which historically took 3 to 4 weeks, took 3 to 4 months in 2017. Actually talking to an agent about a VCP submission, which used to take not more than 6 to 8 months in prior years took nearly a year or more in 2017. It appears that some of this is being repaired, and the timeliness of the VCP process is improving. But, it has been a long time in coming.

Anyone working in the retirement plan industry knows what all of this means. If formal correction of an error is too expensive, too disorganized, and too painful, no one will do it. This may leave some plan sponsors with a Hobson's Choice: a less effective and more expensive government system, correcting without IRS involvement (with the attendant risk on plan audit of a sanction that exceeds the costs of the VCP program), or something that may run from noncompliance to fraud. All of this in lieu of a program that worked – and worked well – to bring the retirement community and the government together to keep plans in compliance. Yikes.

Final Thoughts …

The past several years have seen a significant deterioration in the cooperative relationship between the IRS and the benefits community. In the 1980s, the IRS unsuccessfully launched an attack on small defined benefit plans, which resulted in a lot of tax court litigation and lots of bad feelings. In the years between then and the IRS's recent spate of bad publicity in 2012 and 2013, the Employee Plans Division of the IRS engaged in a posture of working with plan sponsors and those who provide services to them to seek "happy mediums" to encourage retirement plan compliance. Notwithstanding a positive relationship, neither the IRS nor practitioners lost sight of the need to protect participants and comply with the tax laws.

This has changed significantly since 2013. While there has been some positive IRS guidance in the past few years that make plans easier to run, there has been a loss of the dialogue between

the IRS and private community that has led … sadly … to some bad decision-making that is contrary to the common goal of encouraging retirement.

One can only wonder if, relieved of many determination letter and VCP submissions, the IRS redirects its resources toward auditing plans. If the IRS is less responsive to plan sponsor needs and then also increases plan audits, the result could be to discourage the adoption of retirement plans by companies.

At a time when employers need more encouragement to help employees save for retirement, the trend at the IRS does the exact opposite. The increased risk that the employer takes on due to a lack of communication with the IRS, coupled with the increased expense of correcting any failure, is a move in the wrong direction. This is just bad for everyone and not something to crow about.

Pensions on Peachtree – April 22-24, 2018 – Atlanta, GA – Save the date!

The professional educators at FIS and Ferenczy Benefits Law Center are joining forces to bring you their fifth annual Pensions on Peachtree conference in 2018.

This intimate regional conference offers you the chance to get close and personal with our panel of speakers composed of Alison Cohen, Ilene Ferenczy, Robert Richter, David Schultz, and Derrin Watson. Mingle with them and other attendees at Ilene's home BBQ. Bring your most intriguing questions and issues to them during the program and at the "Ask the Oracles" session.

You may earn up to 15 hours of continuing education credits (50 minutes per hour), including 2 ethics credit hours.

The conference will take place at the Atlanta Marriott Century Center/Emory Area, in Atlanta, GA.

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