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IN HER CAPACITY AS
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BEFORE THE
HOUSE COMMITTEE ON SMALL BUSINESS
SUBCOMMITTEE ON ECONOMIC GROWTH, TAX & CAPITAL ACCESS
ON THE IRS' EMPLOYEE PLANS FEE CHANGE
AND THE IMPACT ON SMALL BUSINESS RETIREMENT PLANS
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INTRODUCTION

Chairman Brat, Ranking Member Evans and Members of the Subcommittee, thank you for the opportunity to testify on small businesses and the IRS Employee Plan Compliance Resolution System (EPCRS). Since January, I have been in a temporary posting as Director of the IRS Tax Reform Implementation Office, having stepped away from my position as Commissioner of the Tax-Exempt/Government Entities (TE/GE) Division. I was serving in TE/GE at the time of the fee change at issue.

EPCRS is a comprehensive system of correction programs designed to help retirement plans, including those of small employers, correct technical mistakes. Qualified retirement plans offer significant tax benefits to employers and employees, including current deductibility of certain employer contributions and deferral of tax on the retirement fund. Yet these benefits are available only on fulfillment of the numerous legal requirements that govern eligibility, vesting, and distribution, among other topics, which can confuse employers, especially small businesses, who sponsor qualified plans. EPCRS offers relief from errors in form or operation that could otherwise result in significant tax consequences to the plan sponsor, participants, and trust fund.

Currently, EPCRS contains provisions intended to benefit or assist the small business sector. The Self-Correction Program (SCP) contains flexible provisions permitting both individual plan sponsors and financial institutions providing services to employer-sponsored retirement plans, including Simplified Employee Pensions (SEPs) and Savings Incentive Match Plans for Employees of Small Employers maintained in Individual Retirement

Arrangements (SIMPLE IRA Plans) to self-correct operational defects. Additionally, EPCRS has special provisions for small corrections, including recovery of small overpayments and the distribution of small excess amounts, which may have greater applicability to small business, even though the provisions are available to all plans.

Since the creation of EPCRS a couple of decades ago, the applicable fees have been on a "sliding scale" relative to plan size, favoring small business. Incentives for voluntary compliance were implicit at the inception of EPCRS, even before there could have been historical data on program costs. Through a series of governing revenue procedures, the IRS has adjusted the fees over the years. Although the IRS recently changed the fees for one program within EPCRS – the Voluntary Correction Program (VCP), which is described in more detail below – the sliding scale persists.

OVERVIEW OF EPCRS

The IRS and the Department of the Treasury developed EPCRS to provide a remedy for retirement plan failures without having to revoke the qualified status of the plan under the tax law. Otherwise, revocation could have a dramatic impact on not just the plan sponsor, who may lose deductions for contributions, but also on plan participants and beneficiaries whose benefits generally would become currently taxable if revocation occurred.

Currently, Revenue Procedure 2016-51 sets forth the requirements for the three components of EPCRS:

- Self-Correction Program (SCP), mentioned above, is available for a sponsor of a qualified plan that has either insignificant operational failures or significant operational failures that the plan sponsor proactively identifies and corrects in a timely fashion (basically, within two years). To correct the failure, the plan sponsor must establish practices and procedures reasonably designed to promote and facilitate overall compliance with the tax law so that the error does not recur. The plan sponsor must maintain adequate records to demonstrate the correction in the event of an audit of the plan. As the name implies, the IRS does not review self-correction, and consequently, there is no fee for SCP. By the same token, SCP focuses on those types of errors that are susceptible to clear correction methods, which require little judgment, as prescribed in the revenue procedure. Other types of failures that do not fit within SCP may qualify for the other EPCRS components described below.

- Voluntary Correction Program (VCP) allows plan sponsors proactively to identify and correct a wide range of operational or form failures that are either not small enough to qualify for SCP or occur beyond the two-year SCP window. To enter VCP, the plan sponsor completes an application form that identifies the mistake, proposes the appropriate correction method, and remits a fee for the IRS to review the application. Upon approval, the IRS issues a compliance statement indicating that the correction is proper. Under VCP, the IRS can review the correction and work with the plan sponsor, adjusting the correction method to resolve complex mistakes.

- Audit Closing Agreement Program (Audit CAP) may address plan operational and form failures that are not eligible for SCP or VCP because of the type of failure or because they are discovered by the IRS. Audit CAP is most often employed on examination where the failure is discovered by the IRS. Audit CAP may be the last option before plan revocation. This program permits the plan sponsor and the IRS to enter into a closing agreement that defines the terms of plan correction for a negotiated sanction amount that is less than the Maximum Payment Amount (*i.e.* the tax that would be due if the plan were disqualified). Audit CAP sanctions are based on facts and circumstances. The sanctions are more than the VCP fees because the errors are not generally identified by the plan sponsor and are not based on the cost of processing an application, but reflect the nature, extent, and severity of the failures. Relevant factors for Audit CAP sanctions include: the extent of internal controls designed to ensure that the plan had no failures or that such failures were identified and corrected in a timely manner; number of affected employees; impact on staff ("non-highly compensated employees"); type of failure, whether demographic or employer eligibility; length of time over which the failure occurred; and reason for the failure. Audit CAP is a voluntary program, but because errors are generally found by the IRS, failure to come to an agreement on correction will often result in plan disqualification.

HISTORY OF EPCRS

The history of EPCRS goes back to the establishment of the Audit CAP pilot program in the early 1990s, in which plan sponsors could correct deficiencies found on audit based on a percentage of the tax that would be due if the plan were disqualified.

In 1992, the Voluntary Compliance Resolution (VCR) program began as a pilot program that became permanent in 1994, allowing plan sponsors who had favorable determination letters to disclose operational violations to the IRS, make the required corrections, pay a fee to the IRS, and receive confirmation of the plan's continued qualified status.

To ameliorate plan failures and the adverse consequences to innocent participants and beneficiaries while still maintaining the incentive for plan sponsors to abide by the tax law, Revenue Procedure 98-22 modified and consolidated the various correction programs into one comprehensive system for sponsors of retirement plans referred to as EPCRS. In 2001, various programs were combined into what is now known as VCP.

Congress has repeatedly endorsed EPCRS. On the 1998 enactment of the IRS Restructuring & Reform Act, the Senate Finance Committee report stated:

> [I]t is important to allocate sufficient funds for EP/EO staffing adequately to monitor and assist businesses in establishing and maintaining retirement plans. Recently, in Revenue Procedure 98–22, the IRS announced the expansion of the self-correction programs it offers employers to encourage companies to identify and correct errors without incurring significant penalties. These changes are welcomed ….

In the Pension Protection Act of 2006, sec. 1101, Congress praised EPCRS, as created by Revenue Procedure 98-22, especially VCP, directing the IRS to continue to update and improve EPCRS, by focusing on the concerns of small employers, and assure that any tax, penalty or sanction is not excessive and bears a reasonable relationship to the nature, extent and severity of the compliance failure.

EPCRS FEES

When a qualified plan does not meet the tax requirements, there are many potential ramifications. The IRS may disqualify the plan; disallow the plan sponsor's deduction for contributions to the plan; and tax the income of the trust, participants, and beneficiaries. These potential ramifications encourage a plan sponsor to meet the tax requirements and to fix any problems when they arise.

As introduced above, VCP and Audit CAP are two of the programs in EPCRS designed to help plan sponsors fix these problems. The difference between the two programs is the timing and the payment necessary to participate in each program.

A plan enters VCP prior to examination by IRS. Under VCP, the plan sponsor and the IRS work together to correct any qualification failures. At the conclusion of the process, the IRS will issue a compliance statement, which resolves the issues. To participate in VCP, the plan sponsor must pay a fee authorized by statute to offset the cost of the program.

On the other hand, Audit CAP applies when a retirement plan is under examination by the IRS. Under this program, the plan sponsor and the IRS can agree to resolve an examination. At the conclusion of the process, the parties will sign a closing agreement pursuant to statutory settlement authority.

As part of Audit CAP, the plan will have to pay a sanction amount. The amount is based on a number of factors including, but not limited to: the income tax ramifications of disqualification; the culpability for the plan failure; the efforts to fix the failure; and the total number of affected employees. Audit CAP sanction amounts tend to be significantly larger than VCP program fees.

PERIODIC ADJUSTMENT OF PROGRAM FEES

From 1994 through 2001, the fees for VCR were on four tiers based on a combination of the size of plan assets and the number of participants. The fees ranged from $500 for plans with few assets and participants to $10,000 for plans with many assets and participants. (The dollar amounts of the fees for these programs are not indexed for inflation.)

In 2002, the fees for VCP changed to a range based on a presumptive amount. The presumptive amount ranged from $2,000 for small plans up to $35,000 for large plans. The fee was generally the presumptive amount unless certain factors applied to move the fee up or down. However, the fee for applications based on operational failures continued to follow the pre-2002 fee schedule.

In 2003, the fees changed again. The new structure had eight tiers based on the number of plan participants. The fees ranged from $750 for the smallest plans to $25,000 for the largest plans. This fee structure remained in place until 2016.

In 2016, the fee structure changed to six tiers generating a range of fees, from $500 for the smallest plans to $15,000 for the largest plans. Until

2018, VCP also provided for miscellaneous user fees for specific types of plan failures, such as the failure to make minimum distributions or the failure to make payments under a plan loan. These amounts were generally less than the standard fees.

In 2018, the VCP fees changed to three basic tiers based on the amount of plan assets. Also, most of the miscellaneous user fee amounts imposed for specific types of plan failures were eliminated. The fees now range from $1,500 for the smallest plans, to $3,000 for larger plans, to $3,500 for the largest plans.

The 2018 VCP fees were determined by multiplying the average hours needed for the IRS to complete VCP cases by the IRS's hourly staff cost of processing the cases. Analysis of data from previous years revealed that a steeply tiered system based on the number of plan participants was no longer appropriate. The data showed that the average time spent and complexity of each case did not vary significantly across VCP applications based on plan size. Specifically, to issue a compliance statement approving the correction of a plan's qualification failure, the IRS staff cost did not vary greatly depending on the size of the plan. Consequently, changes to the fees were necessary to more accurately reflect the resources required to administer the VCP program.

CONCLUSION

Although changes to the fees were necessary to more accurately reflect resources required to administer the program, the recent VCP user fee changes continue to reflect special concern for small employers. In particular, the fee for plans with the smallest amount of plan assets ($1,500) is less than half of the fee for the largest plans ($3,500). Within this narrower range, a "sliding scale" of user fees that depends on plan size persists.

Chairman Brat, Ranking Member Evans and Members of the Subcommittee, this concludes my statement. I would be happy to answer your questions.