

# The Nuts And Bolts About Self-Correction And Voluntary Compliance Programs

By Ary Rosenbaum, Esq.

Our tax system rests on voluntary compliance and the assumption that taxpayers will abide by the law. Voluntary compliance is based on taxpayers complying with the law and the use of the audit by the Internal Revenue Service and/or Department of Labor (for retirement plans) is an effective check and tool to encourage it. Voluntary compliance as it pertains to qualified retirement plans means that each plan sponsor must comply with the Internal Revenue Code and ERISA (Employee Retirement Income Security Act of 1974). Audits of qualified retirement plans by the Internal Revenue Service (IRS) or Department of Labor (DOL) can result in substantial penalties if compliance errors are detected. For plans that are so out of compliance, the Internal Revenue Service (IRS) could hit them with disqualification which would disallow prior contribution deductions to the plan sponsor and immediate income to participants in the amount of their account balance. Thankfully, the IRS and DOL have created voluntary compliance programs to encourage voluntary compliance and to encourage plan sponsors to fix problems they discover. These programs offer reduced penalty amounts and if you have a plan error to fix, get it done.

## Don't play the audit game

When you discover compliance errors or when your Third-Party Administrator (TPA) does, I'm sure you might consider playing what I call the "audit game". The audit game means that since the statute of limitations on a Form 5500 is three years,

you would gamble that the IRS or DOL won't audit the plan, so you don't have to make corrective contributions or some other change. The problem with playing the audit game is that it's a bad gamble. First off, some errors such as a missing Form 5500 or missing amendments and restatements have no statute of limitations. Second, I'm not good at poker, but I'm not willing to bet the house against the dealer (the DOL and IRS). Correcting compliance errors through self-correction/voluntary compli-



ance programs is far less expensive than fixing it under an audit because correcting it yourself on your time instead of the auditor's time will save you money in penalties. The reason I don't gamble is I hate to lose

## The Self Correction Program

The IRS has developed a framework of voluntary correction by plan sponsors under an umbrella called the Employee Plans Compliance Resolution Program (EPCRS). One of the most important programs under this umbrella is the Self Correction Pro-

gram (SCP). The beauty of SCP is that as a plan sponsor, you can self-correct many plan errors without having to submit the plan to the IRS or paying a fee. Under the SCP, you can self-correct an insignificant operational error at any time to preserve the tax-qualified status of your retirement plan. An operational error occurs when you don't follow the written terms of the plan. Even where the operational error is significant, you may still be able to self-correct if your corrective action is taken in a timely manner (usually within two years). The IRS has increased the availability of the SCP program for these significant operational errors, as well as certain retroactive amendments than used to be reserved for their Voluntary Compliance Program (VCP). With increased ways to be a part of the SCP and avoid a VCP application that might require payment to IRS for a \$3,000 to \$3,500 for the program fee, I suggest that if you have errors that can be corrected through SCP, you should do it.

## The Voluntary Compliance Program

If you can't correct plan errors through SCP, correcting your plan mistakes through VCP is what you need to do. Retirement plans that are not tax-favored or "qualified" have significant costs that directly affect the plan, its participants, and your business. Unlike the SCP program, an application is made to the IRS along with payment for a program based on plan assets (for example, a \$10 million pays a \$3,500 VCP compliance fee. The reason that you apply to VCP and not SCP is because there are many reasons why you can't self-correct without

IRS approval. Examples include failure to restate the plan document timely or significant errors that occurred several years prior, outside the scope of the SCP program. Another reason you might want to file for VCP instead of SCP is that you might prefer a written IRS approval even to correct failures that are eligible for SCP and there are certain federal income and excise tax relief is available under VCP, but not under the SCP. While you might be wary of shelling out thousands in compliance and legal fees under the VCP program



#### **The Voluntary Fiduciary Compliance Program**

The IRS doesn't have a monopoly on compliance programs as while they enforce the Internal Revenue Code, the DOL enforces ERISA. The first program that the DOL controls is the Voluntary Fiduciary Compliance Program (VFCP). The VFCP is designed to encourage plan sponsors by self-correcting certain violations of ERISA. Unlike other compliance programs, the VFCP is open to anyone who may be liable for fiduciary violations under ERISA, including retirement plan sponsors, plan providers (who are fiduciaries), plan trustees, and parties in interest. If you committed a fiduciary breach, you should voluntarily apply to the DOL VFCP program for relief from enforcement actions from the DOL. The VFCP program provides descriptions of 19 categories of prohibited transactions and the way they can be corrected under VFCP. These days, the most popular use for the VFCP is dealing with the late deposit of salary deferral contributions. Too many plan sponsors and plan providers believe they can merely self correct a late deposit without application to the VFCP program. I disagree and the reason is that plan sponsors do have to answer on whether they have late deferral contributions for Form 5500. I have seen plan sponsors that don't file a VFCP application either get audited or they get a letter from the DOL at a certain point, noting the late deferral; deposits and noting that

they don't have a VFCP application from them. If the DOL is asking you why they don't have a VFCP application for late salary deferral deposits from you, it means you should have submitted one. There is no cost to file, so there is no excuse and I believe that it will help narrow the chances of an audit. If you self correct without an application. Other fiduciary breaches that you can correct through the VFCP are loans and transactions to parties in interest; improper plan expenses; and payment of unnecessary compensation. If there is a fiduciary breach, the DOL is far more lenient through the VFCP than they are on an audit.

#### **The Delinquent Filer Voluntary Compliance Program**

Retirement plans covered under ERISA have an annual tax return called a Form 5500 that must be filed annually. The problem with late or missed filing is that the penalties from both the IRS and the DOL are costly. The DOL penalty alone is a backbreaking \$2,194 a day for a late 5500. So if you're late with a Form 5500 and want to avoid a costly penalty, you only have one choice to make because eventually, the DOL and/or IRS will notice whether your Form 5500 is late or missing (electronic filing makes it clear when you find it). The DOL's Delinquent Filer Voluntary Compliance Program (DFVCP) was created as a way for plan sponsors to voluntarily fix late and missed Form 5500 filings without killing them with penalties.

The DFVCP would give you the chance by submitting the late Form 5500(s) and voluntarily paying a reduced penalty amount. To increase incentives for delinquent plan sponsors to voluntarily file late returns, the DOL greatly reduced penalties under the DFVCP. The maximum penalty for a single late Form 5500 is \$750 for a small plan (generally a plan with fewer than 100 participants at the beginning of the plan year) and \$2,000 for a large plan. If you have multiple late Form 5500s, like Monty Hall, has made a deal for you. The DFVCP has a "per plan" cap. This cap allows you to file multiple late returns and pay just one price. The "per plan" cap limits your penalty to \$1,500 if you have a small plan and \$4,000 for a large plan regardless of the number of late returns for our plan that you have to file. If you have late Form 5500(s), this is a no-brainer because eventually you will get hit with a penalty if the Form was late or still is missing. Work with your TPA to get the plan submitted under the DFVCP and making sure that the DFVCP box is checked when filing a later Form 5500 electronically.

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