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BENEFITS & COMPENSATION UPDATE

IRS Launches 90-Day Pre-Examination Compliance Pilot*

On June 3, 2022, the IRS announced a pilot program to notify plan sponsors of an upcoming audit 90 days before its commencement. During this 90-day window, plan sponsors have the chance to avoid an examination and the potentially high sanctions that may result from the examination by using the principles of the Employee Plans Compliance Resolution System (“EPCRS”) to self-correct or otherwise address mistakes in the plan.

90-Day Window

Under the pilot program, the IRS will send plan sponsors a letter informing them that their plan was selected for an upcoming examination. Plan sponsors will then have 90 days to review the plan’s document and operations for compliance with tax law requirements.

Conducting the Review

The plan sponsor has 90 days to conduct the review. If any issues are discovered during this period, the plan sponsor may either self-correct the mistake or request a closing agreement. The plan sponsor’s options depend on whether the issue is eligible to be resolved under EPCRS.

Self-Correction

Some mistakes are eligible to be self-corrected under EPCRS. These mistakes include certain operational failures, such as the failure to follow the terms of the plan or loan failures. Whether

an error can be self-corrected depends on when the failure occurred and whether the error is “insignificant” or “significant” based on all facts and circumstances.

Unlike normal EPCRS self-correction procedures, the 90-day pre-examination pilot program will require the plan sponsor to submit documentation related to the issue and how they addressed it. The documentation required may include a signed copy of the plan document and all amendments relating to the years at issue, participant allocation schedules, and any additional documentation relating to the specific issue identified by the IRS.

Closing Agreement

When an issue is discovered that is not eligible for self-correction under EPCRS, such as the failure to timely adopt an optional plan design amendment, the taxpayer may request a closing agreement from the IRS. The Voluntary Compliance Program (“VCP”) fee structure will be used to determine the sanction amount paid under the closing agreement. VCP fees depend on the amount of net plan assets and are capped at \$3,500.

VCP fees are usually lower than settlements paid during formal IRS audits under the Audit Closing Agreement Program (“Audit CAP”). Under Audit CAP, the amount of the sanction is negotiated with the IRS and is generally a percentage of the tax the IRS would collect

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upon plan disqualification. The Audit CAP sanction may therefore be a significant dollar amount. The 90-day pre-examination compliance program will allow an audited plan sponsor to enter a closing agreement according to procedures similar to Audit CAP, but with fees based on the lower VCP schedule.

Closing the Pre-Examination Process

Plan sponsors should be aware that even after taking appropriate action, the IRS may decide to move forward with an examination. After the plan sponsor makes self-corrections or requests a closing agreement, documentation should be submitted to the IRS according to instructions in the initial letter.

The IRS will review the documentation and either issue a closing letter or conduct a limited or full scope examination.

Examination if No Response

If the IRS receives no response within 90 days of notifying the plan sponsor of the upcoming examination, then the IRS will contact the plan sponsor to schedule the examination.

Key Takeaways

The 90-day pre-examination compliance program may allow plan sponsors to avoid time-

consuming examinations and costly sanctions. However, in certain cases 90 days may not provide sufficient time to identify and correct any failures. Therefore, it is important that plan sponsors routinely self-audit their plan's document and operations.

Plan sponsors should keep the following in mind if they receive a letter from the IRS initiating a 90-day pre-examination period:

- A response to the IRS must be sent, and appropriate action must be taken, within the 90-day window.
- Not all errors are eligible to be self-corrected under the principles of ECPRS.
- Closing agreements reached under the 90-day pre-examination compliance program will include sanctions determined according to the VCP fee structure, which are likely to be significantly less than equivalent Audit CAP sanctions.

Plan sponsors should promptly consult their benefits advisors upon receiving an IRS notice to discuss the legal and other considerations applicable to moving forward under the 90-day pre-examination compliance program.

This update is not intended to provide legal advice with respect to any particular situation, and no legal or business decision should be based solely on its content.

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