Chapter 5

A Guide to Determination Audit CAP

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Overview

Introduction

The purpose of this chapter is to provide Employee Plans Determinations Specialists with the necessary tools to perfect a case under the Audit Closing Agreement Program. The chapter updates the 2003 CPE material for Rev. Proc. 2003-44, which modified and superceded Rev. Proc. 2002-47 and general policy concerns. The material will focus strictly on determination issues and provides the following:

- Sample closing agreement language,
- Sample correction methods, *and*
- Sample negotiation techniques.

In This Chapter

This chapter contains the following topics:

Continued on next page

Overview, Continued

Self-Correction Program

Introduction

Part IV of Rev. Proc. 2003-44 provides guidance with regard to the Self-Correction Program (SCP). SCP permits a Plan Sponsor to self-correct an Operational Failure, either voluntarily or pursuant to an examination of the plan if the failure is insignificant. If correction is made in accordance with the SCP guidelines, Audit CAP is not required and no fee or sanction is payable.

EP Determinations has no authority to examine a plan, and it cannot approve SCP as an alternative to Audit CAP. Accordingly, determination specialists who discover an Operational Failure while reviewing a determination letter application for a plan should refer the plan for examination in accordance with EP Determinations QAB 2004-3, Processing of Examination Referrals. **The QAB superseded the Best Practices Memorandum issued December 21, 1998.**

SCP and Plan Amendment

Section 4.05(2) of Rev. Proc. 2003-44 permits a Plan Sponsor to self-correct an Operational Failure by amending the plan to conform its terms to its prior operations, but only if such Operational Failure is one of three failures described in section 2.07 of Appendix B to Rev. Proc. 2003-44. These failures include:

1. Allocations based on compensation in excess of the applicable Code section 401(a)(17) limit,

2. Hardship distributions from a plan with no provision for such distributions, *and*,

3. Inclusion of an employee in the plan prior to completion of the plan eligibility requirements.

Appendix B clearly defines the provisions that must be included in the amendment to correct each failure. As with any corrective amendment under Rev. Proc. 2003-44, the plan amendment must comply with the requirements of Code section 401(a), including the requirements of Code sections 401(a)(4), 410(b), and 411(d)(6).

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Self-Correction Program, Continued

SCP and Plan Amendment (continued)

If the Operational Failure is self-corrected via plan amendment as described above, the Plan Sponsor must submit a determination letter application during the correction period. The correction period is defined in section 9.02 of Rev. Proc. 2003-44 as the period ending on the last day of the second plan year following the plan year in which the failure occurred. There is a separate user fee for the determination letter application. No approval of SCP is necessary for EP Determinations to issue the determination letter. The determination specialist should ensure that the terms of the amendment are compliant with section 4.05(2), section 2.07 of Appendix B and all applicable qualification requirements.

If the failure is not one described in section 2.07 of Appendix B, Audit CAP is the only EPCRS program available to the Plan Sponsor. The terms of both the amendment and the provision that was superseded would not, on their face, violate a specific qualification requirement, and no Plan Document Failure exists. Since no defective plan provision arose from the amendment, the remedial amendment period of Code section 401(b) would not be applicable, and Audit CAP is necessary to resolve the Operational Failure.

Audit CAP

Failures that can be Resolved Under Audit CAP

If the Service identifies a Qualification Failure at any point in the determination letter process, it may resolve the failure(s) under the Audit Closing Agreement Program (Audit CAP).

The Plan Sponsor must:

- Correct the failure(s) by using the correction method prescribed by the Service,
- Pay a sanction, *and*
- Satisfy additional requirements to improve the plan's administrative practices and procedures to ensure continued compliance with the terms of the plan, the Code, and the Regulations.

Types of Qualification Failures

A Qualification Failure means any failure that adversely affects the qualification of a plan. The term includes four types of failures:

- A Plan Document Failure,
- An Operational Failure,
- A Demographic Failure, *and*
- An Employer Eligibility Failure.

Certain Issues Cannot be Resolved under Audit CAP

Audit CAP is not available for the following issues:

- Diversion or misuse of assets,
- Excise tax liabilities,
- Income tax liabilities that are not directly related to plan disqualification,
- Additions to tax (e.g., Code section 72(t)), or
- Employment tax liabilities.

Qualification Failures

Plan Document Failure

A Plan Document Failure is a plan provision (or absence of a provision) that violates the requirements of Code section 401(a). A Plan Document Failure also includes a failure to amend the plan for a newly enacted qualification requirement within the applicable remedial amendment period under Code section 401(b). This is commonly referred to as a "nonamender" failure.

> Common nonamender failures include a failure to timely amend a plan to comply with the Tax Reform Act of 1986 (TRA '86), the Unemployment Compensation Amendments of 1992 (UCA '92) and Omnibus Budget Reconciliation Act of 1993 (OBRA '93).

Both examination and determinations agents may discover Plan Document Failures during their review of the initial plan document or plan amendments.

The determinations agent will review the technical screening notations on Form 5621 when opening a new determination case.

Operational Failure

An Operational Failure means any Qualification Failure (other than an Employer Eligibility failure) that arises solely from the failure to follow the terms of the plan.

An Operational Failure is a common problem that is resolved under Audit CAP by specialists who are examining a plan. For example, a Plan Sponsor may fail to follow the terms of the qualified plan for eligibility (Code section 410). Also, the Sponsor may or may not properly count years of service, according to the plan terms, and improperly vest participants (Code section 411).

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Qualification Failures, Continued

Operational Failure (continued)

Determination specialists who identify an Operational Failure while reviewing a determination letter application for a plan should refer the plan for examination in accordance with EP Determinations QAB 2004-3, Processing of Examination Referrals. The QAB can be accessed at the following link: Quality Assurance Bulletins.

If EP Classification does not assign the referral to EP Examination or if EP Examination declines to examine the plan, the referral will be returned to the determination specialist who will resume working the case to completion and issue the determination letter. Before the letter is issued, the specialist should consult with the EP Determinations closing agreement coordinator about the necessity of a closing agreement to remedy the Operational Failure.

As noted on pages 34 and 35, determination specialists are now required to secure a statement of operational compliance before a closing agreement to resolve a Plan Document Failure can be approved by the Manager, EP Determinations Quality Assurance. If a Plan Sponsor concedes that an Operational Failure occurred, the specialist should consult with the EP Determinations Audit CAP Coordinator about the possibility of expanding the scope of the tentative closing agreement to include the failure. .

Demographic Failure

A Demographic Failure means a failure to satisfy the requirements of Code sections 401(a)(4), 401(a)(26) or 410(b) that is not an employer eligibility failure or an operational failure.

Employer Eligibility Failure

An Employer Eligibility Failure means adoption of a plan intended to satisfy the requirements of Code sections 401(a), 403(b) [Tax Shelter Annuity plan], or 408(k) [SARSEP] by an employer that fails to meet the employer eligibility requirements to establish a 401(k), 403(b), or 408(k) plan. An Employer Eligibility Failure is not a Plan Document, Operational, or Demographic Failure.

Determination specialists do not review plans under Code sections 403(b) or 408(k), and the only Employer Eligibility Failure specialists will encounter is the improper adoption of a 401(k) plan.

The Maximum Payment Amount and Sanction Amount

Definition of Maximum Payment Amount

For Qualified Plans, the sanction is a negotiated percentage of the Maximum Payment Amount (MPA). The MPA is the monetary amount that is approximately equal to the tax the Service would collect upon plan disqualification, which is:

- The tax on realized trust earnings for all years with an open statute of limitations (Form 1041 and/or 5500)
- The income tax on disallowed deductions of non-vested allocations of employer contributions for open plan years (Form 1120, 1065 or Schedule C for Form 1040), *and*
- The income tax on the vested allocations to participants' accounts under the plan (Form 1040)

Refer to section 5.01(5) of Rev. Proc. 2003-44 for a more precise definition of MPA.

A fixed fee schedule that imposes a nonnegotiable sanction for plans that are nonamenders for GUST and/or prior statutory changes (TRA '86, UCA '92 and OBRA '93, etc.) has been developed and will be published in a forthcoming revenue procedure. Until the schedule is published, Plan Sponsors are permitted to request a sanction negotiated on the basis of the MPA and other relevant factors.

If a plan has multiple nonamender defects, only the highest possible fee is imposed. For example, if a plan is a late amender for GUST and TRA '86, the sanction would be the fee charged for TRA '86 and not GUST and TRA '86 combined.

Estimating or Computing the Maximum Payment Amount

The specialist can ask the Plan Sponsor or the authorized representative to estimate the MPA during the determination process. Alternatively, the specialist can perform his or her own estimate of the MPA. In either instance, the Plan Sponsor or representative should be asked to provide the applicable returns (Forms 5500, 1040, 1065, 1120 or 1120S) for all open years and other supplemental data, such as allocation reports that list participant compensation, contribution allocations, and the vested percentage of each account. If the Plan Sponsor or representative has estimated the MPA, this information should be used to verify that the computations are reasonably accurate. See Chapter 14 of the CPE 2002 text for a template for estimating the MPA.

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The Maximum Payment Amount and Sanction Amount,
Continued

No Extension of Statute of Limitations Necessary With Determination Audit CAP

Remember, there can only be one plan per closing agreement; therefore, if you discover Qualification Failures in more than one of a Plan Sponsor's plans, you'll need to calculate or obtain an estimate of the MPA for each of the plans. This makes it possible for the Service Center to document the sanction at the conclusion of the determination case review.

Determination specialists who are computing the MPA or reviewing an estimate provided by a representative are not required to obtain the consent of the Plan Sponsor to extend the statute of limitations for a taxable year of the trust, the Plan Sponsor or certain plan participants. No consent is needed as a determination case will not result in an adjustment to the tax liability unless the determination is converted to an examination that yields a tax deficiency.

The fact that a statute has expired for a plan year does not exempt the plan from Code section 401(b), which requires a plan to be retroactively amended to the date on which the plan initially failed to comply with the qualification requirements of Code section 401(a). Even if a plan year is closed for assessment and collection of tax, if a disqualifying provision was in effect at any time during the year, the plan will not be qualified unless a corrective amendment is made retroactively effective for the plan year.

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The Maximum Payment Amount and Sanction Amount,
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Determining the Sanction Amount — Factors to Consider

The sanction must bear a reasonable relationship to the nature, extent and severity of the failure. The following factors from section 14.02 of Revenue Procedure 2003-44 are considered when determining the sanction for a Qualification Failure discovered during the determination letter process:

- The steps taken by the Plan Sponsor to ensure that the plan had no failures,
- The steps taken to identify failures that may have occurred,
- The extent to which correction had progressed prior to the determination letter process (including full correction),
- The number and type of employees affected by the failure,
- Whether the failure is a failure to satisfy the requirements of Code section 401(a)(4), 401(a)(26), or 410(b) ,
- The period of time over which the failure occurred (for example, the time that has elapsed since the end of the applicable remedial amendment period under 401(b)),
- The reason for the failure, *and*
- Whether the failures were discovered during the determination letter process.

Please note that the Revenue Procedure 2003-44 eliminated a factor in section 14.02 of Revenue Procedure 2002-47 that required the Service to consider the applicable VCP fee. Too many plan sponsors were interpreting this factor as a ceiling that limited the sanction to the VCP fee or an approximate amount. This was not how the factor was intended to operate, and the factor in Revenue Procedure 2003-44 is specifically designed to make a distinction between the applicable VCP fee and the Audit CAP sanction. Since the Service initially discovered the Qualification Failure during the determination letter process, the Audit CAP sanction will be greater than the applicable VCP fee, except in rare and unusual instances when the particular facts of a case warrant a lesser amount.

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The Maximum Payment Amount and Sanction Amount,
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Additional Factors

There are additional factors to consider, such as:

- Whether the plan has a Favorable Letter, as defined in section 5.01(4) of Rev. Proc. 2003-44,
- Whether the plan has Operational, Plan Document, Demographic, and/or Employer Eligibility Failures, *and*
- Whether the Plan has Transferred Assets as a result of a merger or acquisition transaction. Refer to section 5.01(8) of Rev. Proc. 2002-47 for the definition of Transferred Assets. (See Employee Plans Determinations Quality Bulletin FY 2003 No. 2, dated February 26, 2003, for guidance on Processing Determination Letter Applications Involving Plan Mergers, Consolidations, Spin-offs, or Transfers of Plan Assets or Liabilities. This document is available on the IRS Intranet site.)

Consultation with CAP Coordinator and Determination Group Manager

The specialist will discuss the sanction range with the Determinations Audit CAP Coordinator and his/her manager prior to contacting the Plan Sponsor and/or representative regarding the sanction amount. During the discussion with the Coordinator and his/her manager, the specialist should recommend a sanction amount and identify the factors that support his/her recommendation. If the plan is a nonamender with a nonnegotiable sanction determined in accordance with the fixed fee schedule, no preliminary discussion is necessary unless the specialist is uncertain about the existence of additional Qualification Failures.

Sanction Can Only be Negotiated with Certain Individuals

Remember that only representatives who are enrolled actuaries, licensed attorneys, or Certified Public Accountants may negotiate the closing agreement sanction for their clients. Refer to the Form 2848 and Circular 230 for more information.

A Form 2848 must specifically designate the authority of the representative to enter into and execute closing agreement on behalf of the Plan Sponsor. No specific mention of a closing agreement is required for the representative to discuss the agreement or negotiate for the taxpayer.

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The Maximum Payment Amount and Sanction Amount,
Continued

If Maximum Payment Amount is More Than $ 1 Million

If the MPA is in excess of $1 million dollars, then the specialist and the Determinations Audit CAP Coordinator should consult with the Voluntary Compliance Manager to determine the appropriate sanction.

Payment of Audit CAP Sanction

The Plan Sponsor typically pays the sanction. The plan trustee or trustees may also pay the sanction.

In the case of a plan with several adopting employers (e.g., several entities of a controlled group of companies), two or more Plan Sponsors may allocate the payment of the sanction among themselves.

It is also possible that the sanction will be paid by an entity other than the Plan Sponsor. The Plan Sponsor may be able to get a responsible party (e.g., a third party administrator) to reimburse or pay the sanction. There may be a malpractice insurer who pays the sanction. The sanction may be covered by the terms of a fidelity bond. The plan trustee or trustees may also pay the sanction.

> In one case, where the Plan Sponsor was taken over by the state that it resided in, the individual who was acquiring the assets of the company reimbursed the state for the sanction as one of the conditions of the purchase transaction.

If the sanction is paid by an outside entity, the entity becomes a party to the closing agreement. The terms of the agreement identify the party, specify that it is paying the sanction on behalf of the employer and subject it to the restrictions that apply to payers of the sanction (nondeductibility of payment, no compensation or income to payer or employees of payer). Please be aware that there may be disclosure issues, which require a power of attorney for the third party; check with the Audit CAP coordinator.

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The Maximum Payment Amount and Sanction Amount,
Continued

Processing the Sanction Payment

The sanction is paid to the United States Treasury at the same time that the closing agreement is signed. When sanction payment(s) are received from the Plan Sponsor or another party, the specialist must:

- Verify that the payment equals the sanction amount specified in the closing agreement, *and*
- Verify that the payment is in the form of a cashier's or certified check.

  Failure to secure a cashier's or certified check will cause processing delays for the case. Any personal or corporate checks must be mailed or hand-delivered back to the Plan Sponsor, and a cashier's or certified check must be secured in its place.

Remember, there must be a separate sanction payment for each closing agreement.

Audit CAP for a Plan Document Failure-TRA 86

Plans Must be Amended for TRA '86

Employee Plans Determinations Quality Assurance Bulletin 2000-2, Verification of Prior Plan Documents in the Absence of a Determination Letter, requires a determination specialist to verify that the plan was timely amended to comply with the Tax Reform Act of 1986 (TRA '86), the Unemployment Compensation Amendments of 1992 (UCA '92) and the Omnibus Budget Reconciliation Act of 1993 (OBRA '93). If a plan is initially effective after 1994, such verification is not necessary.

No verification is required if a plan has a TRA 86 determination letter issued under Revenue Procedure 93-39. If a plan has a TRA 86 determination letter issued under Revenue Procedures 90-20, 91-41, 91-66 or 92-60, verification is limited to compliance with UCA '92 and/or OBRA '93. If the plan is an approved TRA '86 master and prototype plan, no verification of UCA '92 or OBRA '93 is necessary.

If a plan is not timely amended for TRA '86, UCA or OBRA 93 within the applicable remedial amendment period under section 401(b), the plan is a nonamender for the particular statutory requirement(s). Unless the Plan Document Failure is resolved through Audit CAP, the plan is disqualified. For more information on the remedial amendment period for TRA '86, UCA and OBRA '93, refer to Rev. Proc.95-12, Notice 96-64, and Rev. Proc. 2001-55.

Audit CAP for a Plan Document Failure-GUST

Introduction

GUST refers to the passage of several recent statutes that require plan amendments:

- "G"--Uruguay Round Agreements Act (GATT)
- "U"--the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA)
- "S"--the Small Business and Job Protection Act of 1996 (SBJPA), *and*
- "T"--the Taxpayer Relief Act of 1997 (TRA '97)

The term GUST also refers to the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA '98), and the Community Renewal Tax Relief Act of 2000 (CRA 2000).

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Audit CAP for a Plan Document Failure-GUST, Continued

GUST Remedial Amendment Period-Rev. Proc. 2001-55 and 2000-20

Pursuant to Revenue Procedure 2001-55, the GUST remedial amendment period for plans that failed to meet the requirements of Revenue Procedure 2000-20 for an additional extension of the remedial amendment period ended on the later of February 28, 2002 or the last day of the plan year beginning in 2001. Plan Sponsors directly affected by the September 11, 2001 terrorist attacks had a later deadline of June 30, 2002.

Section 19 of Revenue Procedure 2000-20 provided for an additional extension of the GUST remedial amendment period if a Plan Sponsor adopted or certified its intent to adopt a volume submitter or master and prototype plan that was submitted by the sponsor/practitioner for a GUST advisory or opinion letter on or before December 31, 2000. The Plan Sponsor was required to adopt or certify its intent to adopt such a plan by the expiration of the original GUST remedial amendment period for its plan. As noted in the previous paragraph, this date is the later of February 28, 2002 or the last day of the plan year beginning in 2001.

It is important to remember that if the plan that the Sponsor actually adopted (or certified its intent to adopt) was not timely submitted for a GUST advisory or opinion letter, the extended GUST remedial amendment period is still applicable if another volume submitter or master and prototype plan of the same sponsor/practitioner was submitted by December 31, 2000.

GUST Remedial Amendment Period-Rev. Proc. 2002-73

Pursuant to Revenue Procedure 2002-73, the extended GUST remedial amendment period ends on the latest of

1) September 30, 2003,

2) the end of 12th month after the advisory or opinion letter is issued for the plan under review by the determination specialist, or

3) if applicable, the end of the 12th month after the last advisory or opinion letter is issued to the same practitioner.

Revenue Procedure 2002-73 also extended the remedial amendment period for CRA 2000 to June 30, 2003. If the extended GUST remedial amendment period is not applicable to a plan, the plan can be separately amended for CRA 2000 on or before this date.

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Audit CAP for a Plan Document Failure-GUST, Continued

GUST Remedial Amendment Period-Rev. Proc. 2002-73 (continued)

Revenue Procedure 2003-72 extended the filing deadline for plans with a GUST remedial amendment period that expired between September 30, 2003 and December 31, 2003 to January 31, 2004. Due to the fact that the January 31, 2004 deadline was a Saturday, the Service posted a notice on the EP Home Page that an application would be treated as timely received if the application was received or postmarked by February 2, 2004.

If a determination letter application was filed by February 2, 2004, the GUST remedial amendment for the plan is extended to the 91st day following the date of the determination letter, regardless of whether the plan had actually been amended for GUST. Plan Sponsors who failed to adopt GUST amendments within the GUST remedial amendment period were required to pay a separate $250 compliance fee (in addition to the applicable use fee amount) when filing a determination letter application under Revenue Procedure 2003-72. This extended filing deadline also applies to CRA 2000.

Determination specialists who are reviewing a determination letter application with a control date on or before February 2, 2004 should secure the $250 fee if the plan is eligible for a determination letter under Revenue Procedure 2003-72 and no GUST amendments were adopted prior to the expiration of the plan's GUST remedial amendment period. No compliance fee is due if amendments that represent a" bona-fide" effort to comply with GUST were adopted within the remedial amendment period.

For purposes of Revenue Procedure 2003-72, "bona-fide" GUST amendments include amendments that are made contingent on the receipt of a determination letter if such amendments are effective upon receipt of the letter. The submission of additional amendments by the employer or a request for additional amendments by the Service during the determination letter process will not cause the amendments to lose bona-fide status.

If a determination letter application for a plan that was not amended for GUST within the applicable remedial amendment period was filed prior to September 4, 2002, a Plan Sponsor can obtain a GUST determination letter under Revenue Procedure 2002-35. A plan will not be eligible for a letter unless it was timely amended to comply with the TRA '86, UCA '92 or OBRA '93. If a plan is entitled to a letter, the determination specialist should secure payment of the compliance fee described in section 3.04 of the revenue procedure.

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Audit CAP for a Plan Document Failure-GUST, Continued

Example 1

Employer Y sponsors Plan Z, a calendar year plan. The plan is individually-designed, and the employer did not sign a certification of intent to adopt a volume submitter or master and prototype plan that was submitted for a GUST advisory or opinion letter by December 31, 2000. The GUST remedial amendment period for Plan Z expired February 28, 2002, and a Form 5300 determination letter application was filed on February 28, 2002 for a GUST restatement adopted on February 25, 2002. The GUST determination letter was issued on October 1, 2002 with a caveat for proposed amendments to correct several defective GUST provisions. The proposed amendments were adopted on November 12, 2002. Since the application was filed by February 28, 2002, the GUST remedial amendment period was extended to the 91st day after the date of the determination letter, or December 31, 2002. The proposed amendments were timely adopted, and Plan Z was timely amended for GUST.

Example 2

Same facts as Example 1, except the determination letter application was filed on September 22, 2002. The application was not filed within the GUST remedial amendment period for Plan Z, and the deadline to amend the plan to correct the defective GUST provisions was February 28, 2002. The application was filed after September 3, 2002, and Plan Z is not eligible for a determination letter under Revenue Procedure 2002-35. The defective GUST provisions were not corrected by the expiration of the GUST remedial amendment period, and Plan Z is a GUST nonamender. The Plan Document Failure must be resolved through Audit CAP, or Plan Z will be disqualified.

Example 3

Employer A sponsors Plan B, which operates on a fiscal year ending July 31. The employer signed a certification of intent to adopt a master and prototype plan that was submitted for a GUST opinion letter by December 31, 2000 on July 30, 2002. The certification was timely signed, and the GUST remedial amendment period for Plan B was extended to September 30, 2003. A Form 5307 determination letter application was filed on September 29, 2003 for a GUST-approved master and prototype plan adopted on July 20, 2003. The plan was adopted by September 30, 2003, and the application, which may be necessary to retain reliance on the opinion letter, was filed by this date. Plan B was timely amended for GUST.

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Audit CAP for a Plan Document Failure-GUST, Continued

Example 4

Assume the same facts as Example 3, except the plan was not amended for GUST and a Form 5307 application was filed on January 15, 2004. Pursuant to Rev. Proc. 2003-72, Employer A paid the $250 compliance fee, and the GUST remedial amendment period was extended to the 91st day after the date of the determination letter. The letter was issued on April 1, 2004 for a GUST-approved master and prototype plan that was submitted in proposed form and adopted on June 29, 2004. The GUST remedial amendment period for Plan B ended on June 30, 2004, and the plan was timely amended for GUST.

Example 5

Same facts as Example 4, except the Form 5307 application was filed on March 1, 2004. The application was filed after February 2, 2004, and the extended filing deadline under Revenue Procedure 2003-72 is not applicable. The opinion letter for the master and prototype plan that was the subject of the certification of intent signed by Employer A was issued in January 2002, and the last opinion or advisory letter was issued to the sponsor/practitioner on October 5, 2002. The GUST remedial amendment period for Plan B expired on October 31, 2003 (the end of the 12th month after the date of the last opinion or advisory letter of the sponsor/practitioner), and Plan B is a GUST nonamender since it was not amended for GUST by this date. The Plan Document Failure must be resolved through Audit CAP, or Plan B will be disqualified.

Impact of Rev. Proc. 97-41 on GUST Compliance

Section 6.05 of Revenue Procedure 97-41 permits all disqualifying provisions of new plans adopted or effective after December 7, 1994, and all disqualifying provisions of existing plans arising from a plan amendment adopted after December 7, 1994, to be corrected at any time prior to the expiration of the plan's GUST remedial amendment period. Determination specialists who identify such a provision should not attempt to resolve the Plan Document Failure through Audit CAP if the GUST remedial amendment for the plan remains open. The provision can simply be corrected by a retroactive amendment. This broad expansion of Code section 401(b) relief from disqualification also extends to any operational failures that resulted from the application of the defective provision.

Audit CAP for a Plan Document Failure-GUST, Continued

Impact of Rev. Proc. 97-41 on GUST Compliance (continued)

If such a failure is revealed during a determination case review, the specialist should advise the Plan Sponsor that the failure should be corrected immediately. No referral for examination is necessary, and the specialist can issue the determination letter once the plan is amended to correct all deficiencies in plan language.

The expansion of the GUST remedial amendment period is not applicable to disqualifying provisions that are subject to a separate remedial amendment period for TRA ’86, UCA ’92, OBRA ’93 or prior legislation. If a plan adopted after December 7, 1994 but prior to January 1, 1995 has one or more defective TRA ’86 provisions, the plan is nonamender for TRA ’86.

If the GUST remedial amendment for the plan has expired, the disqualifying provision is a Plan Document Failure that must be resolved through Audit CAP. Any related Operational Failure should be referred for examination in accordance with EP Determinations QAB 2004-3, Processing of Examination Referrals. If the plan is examined, the examination agent will attempt to negotiate a closing agreement to remedy the Plan Document and Operational Failures. If EP Examination declines to examine the plan, or if EP Classification does not assign the referral to EP Examinations, the specialist should work the case to completion and issue the determination letter. Before the letter is issued, the specialist should consult with the EP Determinations Audit CAP Coordinator about the necessity of a closing agreement to remedy the Operational Failure.

Audit Cap for a Plan Document Failure-EGTRRA compliance

EGTRRA Compliance

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) effected numerous statutory changes that require plan amendments. Notice 2001-42 provided guidance on amending plans to comply with EGTRRA and established a remedial amendment period for EGTRRA that ends on the final day of the plan year beginning in 2005. The EGTRRA remedial amendment period is contingent on the timely adoption of applicable good-faith EGTRRA amendments for each plan year from 2002 – 2005. A good-faith EGTRRA plan amendment must be adopted by the later of:

- The end of the plan year in which the amendment is required to be, or is optionally, put into effect under the plan, or
- The end of the GUST remedial amendment period for the plan.

Example

The GUST remedial amendment period for Plan A, a calendar year plan, expired on September 30, 2003. A Form 5307 determination letter application for the plan was filed on January 15, 2004. Pursuant to Rev. Proc. 2003-72, the GUST remedial amendment period was extended to 91 days after the date of the determination letter. The letter was issued on April 1, 2004, and the GUST remedial amendment period ended on June 30, 2004. The Plan Sponsor was required to adopt applicable good-faith EGTRRA amendments for the 2002 and 2003 plan years by June 30, 2004.

Notice 2001-57-sample plan amendments

Notice 2001-57 provided sample plan amendments that can be used by Plan Sponsors and sponsor/practitioners of volume submitter and master and prototype plans to comply with the requirement for timely adoption of EGTRRA good-faith plan amendments. A plan will be treated as being in compliance with the good-faith plan amendment requirement if the Plan Sponsor adopts the sample faith amendments verbatim, or plan amendments that are materially similar to the sample amendments. The good-faith plan amendment requirement applies to all EGTRRA provisions, and a plan is still required to be timely amended for an EGTRRA provision that is not addressed in the sample amendments.

EP Determinations is currently not ruling on EGTRRA with respect to ongoing plans. However, terminating plans are required to comply with EGTRRA, and plans that are not timely amended for EGTRRA provisions in effect at the date of termination are nonamenders that must be resolved through Audit CAP.

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Audit Cap for a Plan Document Failure-EGTRRA compliance,
Continued

Example

A Form 5310 determination letter application is filed for Plan C, a calendar year plan, on January 5, 2003. The plan was terminated effective November 30, 2002. The Plan Sponsor adopted an approved GUST volume submitter plan on February 28, 2002, and the plan was timely amended for GUST. The volume submitter plan was not submitted for a GUST opinion letter by December 31, 2000, and the GUST remedial amendment period for Plan C expired on February 28, 2002.

The plan was not amended for EGTRRA provisions that became effective in 2002 by the date of plan termination, nor was it amended by December 31, 2002, the final day of the 2002 plan year. Since Plan C was not amended for all statutory requirements in effect on the date of termination by December 31, 2002, it is a nonamender for EGTRRA, and the failure to adopt good-faith EGTRRA amendments is a Plan Document Failure that must be resolved through Audit CAP.

Plan Sponsors of ongoing plans who fail to timely adopt good-faith EGTRRA amendments can file a VCP submission for their plan to resolve the failure and permit the plan's EGTRRA remedial amendment period to remain intact.

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Audit Cap for a Plan Document Failure-EGTRRA compliance,
Continued

Coordination of GUST and EGTRRA Amendments

Many EGTRRA provisions are effective for the plan year beginning in 2002, and Plan Sponsors were required to amend their plans to comply with all applicable provisions by the end of the 2002 plan year. The GUST remedial amendment period ended no earlier than February 28, 2002, and for many plans, the remedial amendment period was extended to no earlier than September 30, 2003.

Not surprisingly, the overlap between the GUST remedial amendment period and the requirement for timely adoption of EGTRRA good-faith amendments within the 2002 plan year resulted in EGTRRA good-faith amendments to a plan being superseded in their entirety by the subsequent adoption of a complete GUST restatement of the same plan.

At first glance, it appeared that Plan Sponsors would have to readopt the EGTRRA good-faith amendments in order to keep their plan compliant with the requirement for timely adoption in the 2002 plan year and preserve the plan's EGTRRA remedial amendment period. However, a Technical Assistance memo issued by Headquarters on December 19, 2003 concluded that a GUST restatement with a general effective date that precedes the effective date(s) of previously adopted EGTRRA plan amendments should not be treated as superseding previously adopted EGTRRA plan amendments that are not incorporated or reflected in the restatement provided the plan is operated in a manner consistent with the EGTRRA plan amendments.

The memo applies for all purposes, including the determination of plan qualification. EP Determinations specialists generally do not review plan operation, and a plan with EGTRRA good-faith amendments that preceded the adoption of a GUST restatement should be presumed to be operating in compliance with the EGTRRA plan amendments.

Audit CAP for a Plan Document Failure-Additional GUST or EGTRRA provisions

Section 401(a)(9)-DC plans-Remedial Amendment Period-Rev. Proc. 2003-72

Revenue Procedure 2003-72 extended the deadline to amend defined contribution plans for the final and temporary regulations under Code section 401(a)(9) to the later of the last day of the plan year beginning in 2003 or the close of the plan's GUST remedial amendment period.

Sponsor/practitioners of volume submitter and master and prototype plans are still required to amend their plans to comply with the regulations by December 31, 2003. Sponsors of master and prototype plans must amend their plans on behalf of adopting employers and furnish each employer with a copy of the amendments. Plan Sponsors who adopt a volume submitter plan after the document was amended for the final and temporary regulations are entitled to rely on the advisory letter for the plan with respect to the amendments. However, Plan Sponsors who adopted a volume submitter plan that was not amended for the final and temporary regulations are required to individually amend their plan.

Pursuant to Revenue Procedure 2002-29, if a plan is timely amended within the GUST remedial amendment period to comply with the final and temporary regulations, the EGTRRA remedial amendment period is applicable to any disqualifying provision of the amendment. If the Plan Sponsor has kept the EGTRRA remedial amendment period intact by timely adopting EGTRRA good-faith amendments, the provision can be corrected at any time prior to the end of the 2005 plan year without resorting to Audit CAP to keep the plan qualified.

Section 401(a)(9)-DB plans-Remedial Amendment Period-Rev. Proc. 2003-10

Pursuant to Rev. Proc. 2003-10, defined benefit plans are not required to be amended for the final and temporary regulations under Code section 401(a)(9) until the end of the EGTRRA remedial amendment period.

The extension of the deadline to file a determination letter application under Rev. Proc. 2003-72 is also applicable to amendments to comply with Revenue Rulings 2001-62 and 2002-27. If the GUST remedial amendment for a plan expired between September 30, 2003 and December 31, 2003, the deadline is extended to February 2, 2004.

Continued on next page

Audit CAP for a Plan Document Failure-Additional GUST or EGTRRA provisions, Continued

Applicable Mortality Table-GAR '94, Rev. Rul. 2001-62-remedial amendment period

Revenue Ruling 2001-62, which designates GAR '94 as the applicable mortality table under Code section 417(e)(3), requires a plan to be amended to comply with GAR 94 by the last day of the plan year that contains the plan's 94 GAR effective date. GAR 94 is effective for distributions with annuity starting dates on or after December 31, 2002; however, a plan is permitted to specify an earlier date in calendar year 2002.

Deemed Compensation-Remedial Amendment Period-Rev. Rul. 2002-27

Pursuant to Revenue Ruling 2002-27, a plan has that treated deemed Code section 125 compensation as compensation for purposes of Code section 415(c)(3) for plan years beginning after December 31, 1997 and prior to January 1, 2002 must be retroactively amended by the end of the 2002 plan to reflect such treatment. A plan that has not included deemed Code section 125 compensation in Code section 415(c)(3) compensation for plan or limitation years beginning before January 1, 2002 must be amended within the plan year in which deemed compensation was initially treated in this manner.

If plan timely amended to comply with Rev. Rul. 2002-27 or 2001-62

Note: If a plan is timely amended to comply with Revenue Ruling 2002-27 or 2001-62, the EGTRRA remedial amendment period is applicable to any disqualifying provision of the amendment. If the Plan Sponsor has kept the EGTRRA remedial amendment period intact by timely adopting EGTRRA good-faith amendments, the provision can be corrected at any time prior to the end of the 2005 plan year without resorting to Audit CAP to keep the plan qualified.

Audit CAP for Plan Document Failure-other provisions

Revenue Procedure 2004-25

Revenue Procedure 2004-25 extended the remedial amendment period for any disqualifying provision of a new plan put into effect after December 31, 2001 or an amendment to an existing plan adopted after December 31, 2001 to the end of the EGTRRA remedial amendment period. This extension does not apply to statutory or regulatory requirements with a separate remedial amendment period established by previously issued guidance. Such provisions include GUST, GAR '94, deemed Code section 125 compensation, CRA, the Code section 401(a)(9) final and temporary regulations and the final regulations under Code section 417 that permit defined benefit plans to be amended to provide for a retroactive annuity starting date, effective for plan years beginning in 2004.

Revenue Procedure 2004-25 does not extend the deadline to adopt good-faith EGTRRA plan amendments. The extension of the remedial amendment period is contingent on the continued timely adoption of good-faith EGTRRA amendments. If a Plan Sponsor fails to timely amend its plan for EGTRRA, the EGTRRA remedial amendment period, including the extension for any disqualifying provision described in Revenue Procedure 2004-25, is no longer applicable to the plan.

As with Revenue Procedure 97-41, the expansion of Code section 401(b) relief from disqualification also extends to any operational failures that resulted from the application of the defective provision. If such a failure is revealed during a determination case review, the determination specialist should advise the Plan Sponsor that the failure should be corrected immediately. No referral for examination is necessary, and the specialist can issue the determination letter once the plan is amended to correct all deficiencies in plan language.

Continued on next page

Audit CAP for Plan Document Failure-other provisions,
Continued

Revenue Procedure 2004-25
(continued)

Example 1

Employer A amended its profit sharing plan on June 5, 2003 to impose a 10-year cliff vesting schedule. The plan operates on a calendar year, and the GUST remedial amendment period expired on February 28, 2002. The plan received a GUST determination letter on August 1, 2002. The employer adopted good-faith EGTRRA plan amendments for the 2002 and 2003 plan years on December 30, 2002 and May 31, 2003, respectively. A Form 5300 determination letter application for the plan is filed on November 1, 2004. Since the plan was timely for EGTRRA provisions that became effective in 2002 and 2003, the plan's EGTRRA remedial amendment period remains intact, and correction of the Plan Document Failure requires a retroactive amendment to restore the prior vesting schedule. Any Operational Failures resulting from the application of the improper schedule can be also be corrected without resorting to Audit CAP.

Example 2

Same facts as Example 1, except Employer A failed to amend its plan for EGTRRA provisions that became effective in 2003. The EGTRRA remedial amendment period was no longer applicable to the plan after December 31, 2003. Since the extension under Revenue Procedure 2004-25 no longer applies, the remedial amendment period for the Plan Document Failure ended on September 15, 2004, the due date of Employer A's Form 1120 for the 2003 taxable year in which the disqualifying provision was adopted. The Form 5300 was filed after this date, and the extension of the remedial amendment period to the 91st day after the date of the determination letter is not applicable. The plan will be disqualified unless the Plan Document Failure is resolved through Audit CAP. If any related Operational Failures are identified by the determination specialist, the plan must be referred for examination in accordance with EP Determinations QAB Processing of Examination Referrals.

Continued on next page

Audit CAP for Plan Document Failure-other topics

VCP Available if Qualification Failure Disclosed by Plan Sponsor

If a Plan Sponsor voluntarily discloses a Plan Document Failure or another type of Qualification Failure in the determination letter application (e.g., within the cover letter or an attachment to the application form), the Plan Sponsor will be given the opportunity to convert the application into a submission under the Voluntary Correction Program. Pursuant to section 5.03(3) of Revenue Procedure 2003-44, the Plan Sponsor will be permitted to perfect a determination letter application into a VCP submission if the Plan Sponsor (or its authorized representative) identifies a Qualification Failure, in writing, to the determination specialist before the specialist recognizes the existence of the Qualification Failure and/or notifies the Plan Sponsor that he or she has revealed the failure.

However, if the Plan Sponsor does not disclose the Qualification Failure prior to its identification by an EP Determinations specialist who is reviewing the application, the failure will have to be resolved through Audit CAP or referred to EP Examinations. In either case, the VCP fee structure in section 12 of Revenue Procedure 2003-44 is not available to the Plan Sponsor. Instead, the Plan Sponsor will be liable for an Audit CAP sanction that is negotiated under the guidelines of section 14 of Revenue Procedure 2003-44.

Failure to Reach Agreement

A closing agreement is not valid until full correction is made, and both parties (the Plan Sponsor and the Service) execute the agreement. Either party may walk away from the negotiations.

If the determination specialist cannot agree with the Plan Sponsor or authorized representative as to correction, the amount of the monetary sanction or the Plan Sponsor's and/or representative's failure to submit requested information, the plan is disqualified. The specialist will have to prepare an unagreed case report, and the case cannot be closed.

You must consult with the Determinations Audit CAP Coordinator and your group manager prior to preparing to close the determination case file as an unagreed case. Also, the group manager and/or Audit CAP Coordinator may request involvement from the Manager, EP Determinations on the more complex and technically difficult cases. Finally, the Plan Sponsor may request a conference with your manager or request to speak with the Audit CAP Coordinator in order to reach an agreement with regard to the sanction amount or correction.

Continued on next page

Audit CAP for Plan Document Failure-other topics, Continued

Importance of Workpapers

An unagreed case report prepared by the determination specialist must be thoroughly supported by documentation in the determination case file. The primary purpose of adequate documentation is to permit someone in EP Determinations Quality Assurance Staff, Appeals or U.S Tax Court to understand the facts, issues, government's position and the Plan Sponsor's position. Therefore, the following items should be documented:

- A precise description of the Qualification Failure and how it was identified,
- The terms of the closing agreement that was rejected by the Plan Sponsor and all correspondence with the Plan Sponsor and/or representative relative to the negotiation ,
- The extent to which the specialist's manager was involved in the closing agreement process, *and*
- Communication with the Determinations Audit CAP Coordinator regarding closing agreement terms and correction requirements.

Adequate documentation is comprised of Form 5464, Case Chronology Record, correspondence with the Plan Sponsor and/or representative, workpapers prepared by the specialist that reflect his/her analysis of the issue and internal memoranda, routing slips, or other correspondence between the specialist, his/her group manager, and the Determinations Audit CAP Coordinator.

Proper documentation of your case file will enable Appeals to use the terms of a closing agreement that you had previously offered to the Plan Sponsor as the basis for a negotiated settlement with the Sponsor. If a settlement cannot be reached, and the Sponsor files a claim with U.S. Tax Court for a declaratory judgment on the qualification of the plan, the documentation is crucial to the successful prosecution of the government's case.

Continued on next page

Audit CAP for Plan Document Failure-other topics, Continued

Tips for Preparing an Unagreed Case Report for a Plan Document Failure

Prepare the case file for a disqualification of the plan and revocation of the determination letter, if applicable. You will need to prepare an Attachment A with your case file. Cite the appropriate Code, regulations, court cases, and other published guidance to support your case. For the law section of your Attachment A, you may refer to the logic and holding in *Buzzetta Construction Company v. Commissioner* and *Martin Fireproofing v. Commissioner*, where the Tax Court affirmed the Service's discretion to retroactively disqualify plans.

With respect to an unagreed report for a Plan Document Failure, determination specialists can cite Code section 401(b) and Income Tax Regulations section 1.401(b)-1 as statutory and regulatory authority for the Service to disqualify the plan for an indefinite period. The regulations under Code section 401(b) have established a statutory remedial amendment period to:

- adopt retroactive amendments to a plan to eliminate a disqualifying provision, or
- conform existing plan provisions to changes in law.

The regulations do not provide for the automatic restoration of plan qualification if a plan is actually amended after the close of its remedial amendment period. Accordingly, if a plan is not properly amended to eliminate a disqualifying provision or comply with changes in certain qualification requirements within the applicable remedial amendment period, the plan is disqualified unless and until the Service permits the Plan Sponsor to restore qualification through Audit CAP or VCP.

For additional information on preparing an unagreed (adverse) case report, see the chapter on Determination Processing.

Negotiating Under Audit CAP

Prepare before Negotiation in a Face-to-Face Meeting

Negotiation of the sanction for a determination Audit CAP is almost exclusively conducted via verbal or written communication. However, EP Determinations specialists will occasionally be required to conduct a face-to-face meeting with the Plan Sponsor and/or its representative if such a meeting is necessary to resolve one or more contentious issues that have stalled negotiations of a closing agreement. The EP Determinations Audit CAP Coordinator and the specialist's group manager should also participate in the meeting.

Before meeting with the Plan Sponsor, be prepared to discuss the issues. The specialist should take the following steps to prepare for the meeting:

- If there are one or more Operational Failures, list the advantages and disadvantages of each proposed correction method, if multiple methods are available. Make sure each proposed correction method resembles, or is consistent with the principles of, a method in the Code, Rev. Proc. 2003-44, or other published guidance,

- Consult with your manager and the EP Determinations Audit CAP Coordinator about your best alternatives and potential abandonment position,

- Explore creative and productive solutions to your complex issues,

- Review the terms of the plan. Certain types of amendments may only be made on a prospective basis. If the Plan Sponsor needs to conform the terms of the plan to prior operations, make sure that the proposed amendment does not raise a Code section 411(d)(6) impermissible cutback issue, and

- Review your notes and workpapers.

Continued on next page

Negotiating Under Audit CAP, Continued

Tips When Negotiating in s Face-to-Face Meeting

- Do not let the Plan Sponsor or the authorized representative intimidate you during your negotiations or follow-up meetings.
- Do not lose control of the meeting(s). Beware of delaying and distracting tactics. Also, be wary of the good guy/bad guy routine that some taxpayers and representatives may use.
- Do not let personality conflicts interfere with your best judgment.
- Consider the facts and circumstances of the case. Determine why the errors occurred and negotiate for changes to the practices and procedures to ensure that the same deficiencies do not recur.
- Maintain your professional demeanor and your sense of humor. A tense meeting may be counterproductive and cause negotiations to collapse. If the meeting gets too intense, take a break. In essence, do whatever you need to do to remain professional and creative as you negotiate with the Plan Sponsor or the representative.

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Negotiating Under Audit CAP, Continued

Negotiation of Audit CAP Sanction

As previously noted, a fixed fee schedule that imposes a nonnegotiable sanction for plans that are nonamenders for GUST and/or prior statutory changes (TRA '86, UCA '92 and OBRA '93, etc.) has been developed and will be published in a forthcoming revenue procedure. Until the schedule is published, Plan Sponsors are permitted to request a sanction negotiated on the basis of the MPA.

The great majority of closing agreement cases processed by EP Determinations involves Plan Document Failures, particularly nonamenders. Although the precise factors may vary from case-to-case, our negotiating position in these cases is primarily based on the following cites of published authority and other internal guidance:

1. IRC §401(b) and regulations thereunder, which formally grant the Service the authority to establish a remedial amendment period and extend it at its discretion,

2. Section 10.07(2) of Rev. Proc. 2003-44, which requires the fee structure in section 14 relating to Audit CAP to apply if a Plan Document Failure is identified by the Service,

3. Section 14.03 of Rev. Proc. 2003-44, which stipulates two factors in determining an Audit CAP sanction that are pertinent to these cases;

    a. Whether the failure(s) were discovered during the determination letter process, and

    b. The time that has elapsed since the end of the applicable remedial amendment period, and

4. Employee Plans Determinations Quality Assurance Staff Bulletin 2000-2, Verification of Prior Plan Documents in the Absence of a Determination Letter, which explicitly states that a Plan Document Failure is deemed to have occurred if a plan is amended for a certain statutory change at any time after the close of the applicable remedial amendment period under IRC §401(b), even if the amendment is adopted in a plan year with a closed statute of limitations.

Correction Principles

Introduction

EPCRS correction principles are described in section 6 of Rev. Proc. 2003-44. Generally, a failure is not corrected unless full correction is made with respect to all participants (former and active), authorized beneficiaries and all taxable years (whether or not the taxable year is closed under statute).

Full correction of a Plan Document Failure will not be attained until the plan is amended to comply with the particular statutory requirement(s), with the provisions of the amendment made retroactively effective to the correct statutory effective date(s) and/or other date(s) specified in guidance published by the Service.

An EP Determinations specialist who is attempting to resolve one or more Plan Document Failures through a closing agreement must secure a statement of operational compliance with the applicable statutory provision(s) before submitting the closing agreement draft to the EP Determinations Audit CAP coordinator for his review. An example of a statement of operational compliance is shown below:

Example

Employer Z amended its profit sharing plan on June 5, 2002, effective January 1, 2002, to impose a 15-year cliff vesting schedule. The employer failed to adopt good-faith EGTRRA plan amendments for the 2002 and 2003 plan years, and the plan's EGTRRA remedial amendment period is no longer intact. Since the plan was not amended for EGTRRA, the Plan Document Failure arising from the amendment of June 5, 2002 is ineligible for correction by retroactive amendment in accordance with Revenue Procedure 2004-25. The plan was also not timely amended for GUST. Employer Z has consented to a closing agreement to remedy the improper vesting provision and the failure to timely amend. As a prerequisite for entering into a closing agreement with the Service, Employer Z submitted the following statement of operational compliance with Code section 411 and GUST:

Continued on next page

Correction Principles, Continued

Example (continued)

"The Profit Sharing Plan of Employer Z was operated in compliance with the vesting requirements of section 411 of the Code for the period January 1, 2002 – (enter date of corrective amendment); further, the plan was operated in compliance with the requirements of the Uruguay Round Agreements Act of 1994 (GATT), the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA), the Small Business Job Protection Act of 1996 (SBJPA), the Taxpayer Relief Act of 1997 (TRA '97), the Internal Revenue Service Restructuring and Reform Act of 1998 and the Community Renewal Tax Relief Act of 2000, collectively, "GUST", for the period January 1, 1995 – (enter date of adoption of GUST restatement of plan)."

If the Plan Sponsor declines to provide the statement, the plan should be referred for examination in accordance with EP Determinations QAB 2004-3, Processing of Examination Referrals. In the unlikely event that the Plan Sponsor concedes that an Operational Failure actually occurred, the specialist should contact the EP Determinations Audit CAP Coordinator to discuss the possibility of expanding the scope of the tentative closing agreement to include the failure.

Full correction is required

EPCRS correction principles are described in section 6 of Rev. Proc. 2003-44. Generally, a failure is not corrected unless full correction is made with respect to all participants (former and active), authorized beneficiaries and all taxable years (whether or not the taxable year is closed under statute).

Full correction of a plan document failure

Full correction of a Plan Document Failure will not be attained until the plan is amended to comply with the particular statutory requirement(s), with the provisions of the amendment made retroactively effective to the correct statutory effective date(s) and/or other date(s) specified in guidance published by the Service.

Full correction of a Plan Document Failure will not be attained until the plan is amended to comply with the particular statutory requirement(s), with the provisions of the amendment made retroactively effective to the correct statutory effective date(s) and/or other date(s) specified in guidance published by the Service.

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Correction Principles, Continued

Correction under Audit CAP

Correction under Audit CAP must be made prior to the execution of the closing agreement by the Plan Sponsor and the Service. If correction is made for a closed year, no further adjustments to any existing tax liability will be made as a result of the correction.

Correction of an operational failure

For a Qualified Plan with an Operational Failure, correction is determined by taking into account the terms of the plan at the time of the failure. Referring back to the plan terms is crucial when choosing an appropriate correction method.

General Correction Principles

- The correction method should restore the plan to the position it would have been had the failure not occurred.

  Restore to both current and former participants and beneficiaries, the benefits and rights that they would have been entitled to had the failure not occurred.

- The correction method should be reasonable and appropriate for the failure.

  For Qualified Plans, any correction method permitted under Appendices A or B of Rev. Proc. 2003-44 is deemed to be a reasonable and appropriate method of correcting the related Qualification Failure.

- The correction method for failures relating to nondiscrimination should provide for benefits for nonhighly compensated employees.

  The correction method should resemble one already provided for in the Code, the regulations thereunder, or other authoritative guidance.

Continued on next page

Correction Principles, Continued

General Correction Principles (continued)

- The correction method should keep plan assets in the trust, except to the extent provided for in the Code, the regulations or other authoritative guidance of general applicability provide for correction by distribution to participants or beneficiaries or return of assets to the Plan Sponsor.

  The correction method should not violate another provision of Code section 401(a)

The correction method should be applied consistently in correcting all Operational Failures of the same type in the same Plan Year. Earnings (or loss) adjustment methods should also be applied consistently to all corrective contributions or allocations for a particular type of failure for a Plan Year.

Specific Correction Methods - Certain Operational Failures

Form 5310 and Operational Failures

Although closing agreements processed by EP Determinations rarely involve Operational Failures, they do occur, especially during a review of a Form 5310 application. Many of these closing agreements require corrective distributions of retroactive benefits that were not initially paid into the plan in accordance with plan provisions. The paragraphs below describe how correction of this type of failure should be implemented.

Continued on next page

Specific Correction Methods - Certain Operational Failures,
Continued

Corrective Distributions—Employee Notices, Spousal Consent

The Plan Sponsor must issue a corrected account balance statement to each Participant. The Plan Sponsor must also distribute the notices that ask for the participants' permission for distributions in excess of either $3,500 or $5,000 (depending on the plan terms and when the plan was amended for TRA '97).

If the plan is subject to Code section 417, spousal consent for the distribution(s) must be obtained. If a spouse does not consent, then the spouse may be entitled to an annuity, and the Plan Sponsor will have to make additional payments to the trust to cover this requirement.

If a distribution is eligible for rollover treatment, the Plan Sponsor must issue the notice to the participant asking for the election of lump sum distribution or rollover treatment. If the distribution is made in a lump sum, the distribution is subject to federal income tax withholding at a 20% rate.

Since some types of corrective distributions (e.g. excess annual additions under Code section 415, excess contributions/aggregate contributions under Code sections 401(k)/(m), minimum required distributions under Code section 401(a)(9)) are not eligible for rollover treatment, the Plan Sponsor must issue notices to the participants informing them that the distributions are subject to 20% federal income tax withholding and are not eligible for favorable rollover treatment.

Corrective Distributions for Plans that have Terminated

Sometimes the Plan Sponsor will have already terminated the plan and distributed assets prior to the determination letter review. In this case, the Plan Sponsor must re-establish the trust account under the plan and then make corrective distributions to the affected current and former participants. If the trust account is not reestablished, the employer must make the distributions directly to the participants.

Workpaper Documentation – Closed Determination Case File

Proper Documentation in Closed Case File

The workpapers for a determination case should be documented with sufficient evidence in support of your conclusions. In addition, the workpapers should document how a determination specialist reached his/her conclusions on the basis of the specific facts and circumstances of the case. If the workpapers are properly documented, your manager and, if applicable, Quality Assurance Staff should able to interpret

1) The issue(s) that were identified during the determination case review and,

2) the analysis that was used to determine the extent of the failure and arrive at the correction methodology.

Although Audit CAP cases are not automatically mandatory review cases, the group manager may select the case for mandatory review, or there may be another issue in the case that may require sending the case to Quality Assurance Staff.

The case chronology should reflect discussions with either the group manager or the Determinations Audit CAP Coordinator. The workpapers should reflect the level of guidance provided by the manager or coordinator during the determination case review.

Any consultations with experts such as an IRS actuary or Quality Assurance Staff personnel should also be reflected in the case chronology

Determination Letter Issued After Closing Agreement Signed

For determination Audit CAP cases, the determination letter will not be issued to the Plan Sponsor until the closing agreement is signed by all parties to the agreement and the representative for the Service.

A Note about Your Self-Assessment

You (determination specialists) may want to keep track of your Audit CAP cases and the Qualification Failures that you resolved under Audit CAP to assist you when you prepare your annual self-assessment. Properly resolved Audit CAP cases are good illustrations of your ability:

- To identify and develop tax issues, *and*
- To apply the tax law and applicable guidance.

Elements of a Closing Agreement

Identification Section

The initial paragraph must contain the full legal name, address, and Taxpayer Identification Number (TIN) of each party to the agreement except for the Service. If a third party is paying the sanction on behalf of the Plan Sponsor, it should also be identified here.

Facts

This section is composed of the paragraphs on page 1 of the closing agreement document that immediately follow the identification section. The paragraphs contain the following information:

A. The Plan Sponsor who established the plan and the effective date of the original plan document ,

B. The fiscal year end of all parties (except the Service). This is optional for determination cases,

C. A complete description of the plan's qualification history, including the dates on which determination letters were issued and/or significant amendments were adopted, and

D. A description of the failure(s) identified during the determination letter process.

Conclusion Section

This paragraph explains the conclusions (e.g. proposed disqualification) that the Service would have reached if the Plan Sponsor had not corrected the Qualification Failure(s) and consented to enter into Audit CAP.

Correction Section

This paragraph explains how each failure was corrected; if there are Operational Failures, the paragraph specifies the amount of any additional employer contributions, distributions from the plan, etc.

NOTE: If you are resolving **more than one failure** within the closing agreement, describe the corrective action taken for each failure separately (e.g., in separate subparagraphs).

Continued on next page

Elements of a Closing Agreement, Continued

Certification Section

This section describes the certification by the Plan Sponsor. No other corrective action is necessary because no participants' rights or benefits have been adversely affected by reason of the Qualification Failure(s). In addition to this certification, EP Determinations specialists are also required to secure a signed statement of operational compliance with the Code section(s) that are the subject of the closing agreement from the Plan Sponsor.

Terms Section

This section defines the terms agreed to by all parties. Specifically, these are the numbered paragraphs and usually consist of:

a.) The amount of the sanction to be paid by the Plan Sponsor (or another party to the closing agreement).

b.) The Service's agreement to treat the plan as if the identified failures had not occurred. If you are resolving more than one failure within the closing agreement, describe the treatment of each failure separately.

c.) The Plan Sponsor's (or a third party that paid the sanction) agreement not to deduct the sanction.

d.) The Plan Sponsor's (or third party) agreement that the sanction cannot be considered as any form of compensation or income to any employees or former employees of the Plan Sponsor (or the third party).

e.) The statement that the closing agreement only resolves the specific failure(s) described within the agreement.

f.) The statement regarding the finality of the closing agreement, etc.

Signature Section

Prepare a signature section on the last page of the closing agreement. A separate line is required for the signature for each party to the closing agreement, including the Service. There must be at least two signature lines on the last page of the closing agreement.

The Plan Sponsor usually signs for the plan. If the plan is a multiemployer plan, the plan trustees typically sign the closing agreement. The Manager, EP Determinations Quality Assurance typically signs for the Service.

Continued on next page

Elements of a Closing Agreement, Continued

Sample Closing Agreements	See Exhibits A and B for sample copies of closing agreement documents for Plan Document Failures

Exhibit 4A Sample Closing Agreement-Nonamender-TRA 86, UCA and OBRA 93

CLOSING AGREEMENT ON FINAL DETERMINATION
COVERING SPECIFIC MATTERS

Under section 7121 of the Internal Revenue Code (the Code), XYZ, Inc., (the Employer), 1111 Maple Drive, Anytown, Nebraska 08999, EIN 88-8888888, and the Commissioner of Internal Revenue make the following closing agreement:

WHEREAS, the XYZ Salaried Employees Retirement Plan (the Plan) was established effective October 14, 1980; and

WHEREAS, the Plan received favorable determination letters in 1987 and 1993; and

WHEREAS, the Employer submitted Form 5310, Application for Determination for Terminating Plan, on April 30, 2001; and

WHEREAS, pursuant to a review of the Application by the Cincinnati TE/GE Division Office of the Internal Revenue Service (the Service), it was determined that the Plan was not timely amended to comply with the Tax Reform Act of 1986 (TRA 86), the Unemployment Compensation Amendments Act of 1992 (UCA 92) and the Omnibus Budget Reconciliation Act of 1993 (OBRA 93) by the required compliance dates in accordance with section 401(b) of the Code and regulations thereunder; and

WHEREAS, the Service proposed revoking the qualified status of the Plan under section 401(a) of the Code retroactive to January 1, 1993 through the Plan year beginning April 1, 2002; and

WHEREAS, the Employer amended the Plan on January 7, 2002 to bring the Plan into compliance with TRA 86, UCA 92 and OBRA 93; and

WHEREAS, the Employer certifies that no other corrective action is necessary because no participants' rights or benefits have been adversely affected by reason of failure to timely amend; and

WHEREAS, the Employer has determined that the agreement, as set forth herein, is in its best interests; and

WHEREAS, the Service, through its authorized representative, has determined that said agreement is also in its best interests;

Continued on next page

Exhibit 4A Sample Closing Agreement-Nonamender-TRA 86, UCA and OBRA 93, Continued

NOW IT IS HEREBY DETERMINED AND AGREED for Federal income tax purposes that:

1. The total amount due to the United States Treasury under this Agreement is ten thousand dollars ($10,000). This sum shall be paid by the Employer to the United States Treasury contemporaneously with the execution of this closing agreement by the duly authorized representative of the Service.

2. The Employer will neither attempt to nor otherwise amortize, deduct, or recover any portion of the payment described in paragraph 1 from the Service or to receive any Federal tax benefit on account of such payment.

3. No portion of the payment described in paragraph 1 shall be considered as: (a) compensation to, or the discharge of any obligation or liability of, any employee or former employee of the Employer; or (b) taxable income to any employee or former employee of the Employer.

4. The Service shall treat the Plan as being timely amended to comply with TRA 86, UCA 92 and OBRA 93.

5. This Agreement constitutes a resolution under the Code of specific matters discussed herein. No inference shall be made with respect to whether this resolution satisfies other Federal law including Title I of the Employee Retirement Income Security Act of 1974.

This agreement is final and conclusive except:

(a) the matter it relates to may be reopened in the event of fraud, malfeasance, or misrepresentation of material fact;
(b) it is subject to the Code sections that expressly provide that effect be given to their provisions notwithstanding any other law or rule of law except Code section 7122; and
(c) if it relates to any taxable period ending after the date of this Agreement, it is subject to any law enacted after the agreement date that applies to that taxable period.

By signing, the above parties certify that they have read and agreed to the terms of this document.

XYZ, INC.

By:_____

Title:_____ Date Signed:_____

COMMISSIONER OF INTERNAL REVENUE

By:_____

Title:_____ Date Signed:_____

Exhibit 4B Sample Closing Agreement-Nonamender for GUST, CRA and EGTRRA for Terminating Plans

CLOSING AGREEMENT ON FINAL DETERMINATION

COVERING SPECIFIC MATTERS

Under section 7121 of the Internal Revenue Code (the Code), ABC Inc. (the Employer), 4444 Oak Avenue, Los Angeles, CA 99999 EIN 66-6666666, and the Commissioner of Internal Revenue make the following closing agreement:

WHEREAS, the ABC Inc. Profit Sharing Plan (the Plan) was established effective September 1, 1985; and

WHEREAS, the plan has not received a favorable determination letter from the Internal Revenue Service (the Service); and

WHEREAS. the Employer adopted a board of directors resolution on January 29, 2002 that approved the termination of the Plan effective February 1, 2002; and

WHEREAS, the Employer submitted Form 5310, Application for Determination for Terminating Plan, on June 29, 2002; and

WHEREAS, pursuant to a review of the Application by the Cincinnati TE/GE Division office of the Service in 2003, the Service determined that the Plan was not timely amended to comply with the requirements of the Tax Reform Act of 1986 (TRA '86), the Unemployment Compensation Amendments of 1992 (UCA), the Omnibus Budget Reconciliation Act of 1993 (OBRA '93), the General Agreement on Trade and Tariffs (GATT), the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA), the Small Business Job Protection Act of 1996 (SBJPA), the Tax Reform Act of 1997 (TRA '97), the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA), and the Community Renewal Tax Relief Act of 2000 (CRA) by the required compliance date(s) in accordance with section 401(b) of the Code and regulations thereunder; further, the plan was not timely amended to comply with the provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) that became effective as of the Plan year beginning January 1, 2002 pursuant to Section 12.06 of Revenue Procedure 2002-6, which requires a plan that terminates after the effective date of a change in law, but prior to the date that amendments are otherwise required to comply with the applicable provisions of law from the date on which such provisions become effective with respect to the plan; and

Continued on next page

Exhibit 4B Sample Closing Agreement-Nonamender for GUST, CRA and EGTRRA for Terminating Plans, Continued

WHEREAS, the Service proposed revoking the qualified status of the Plan under section 401(a) of the Code retroactively to the Plan year beginning January 1, 1989 through the Plan year beginning January 1, 2004; and

WHEREAS, the Plan was amended on November 24, 2003 to bring the Plan into compliance with TRA '86, UCA, OBRA '93, GATT,
USERRA, SBJPA, TRA '97, RRA, CRA and EGTRRA; and

WHEREAS, the Employer has determined that the agreement set forth herein is in its best interests; and

WHEREAS, the Service, through its authorized representative, has determined that said agreement is also in its best interests;

NOW IT IS HEREBY DETERMINED AND AGREED for Federal income tax purposes that:

1) The total amount due to the United States Treasury under this agreement is ten thousand dollars ($10,000). This amount shall be paid by the Employer to the United States Treasury contemporaneously with the execution of this agreement by the duly authorized representative of the Service.

2) The Employer will neither attempt to nor otherwise amortize, deduct, or recover any portion of the payment described in paragraph 1 from the Service or to receive any Federal tax benefit on account of such payment.

3) No portion of the payment described in paragraph 1 shall be considered as:

   (a). compensation to, or the discharge of any obligation or liability of, any employee or former employee of the Employer; or

   (b). taxable income to any employee or former employee of the Employer.

4) The Service will treat the Plan as having been timely amended to comply with TRA '86, UCA '92, OBRA '93, GATT, USERRA, SBJPA, TRA '97, RRA, CRA and EGTRRA.

5. This agreement constitutes a resolution under the Code of specific matters discussed herein. No inference shall be made with respect to whether this resolution satisfies other Federal law including Title I of the Employee Retirement Income Security Act of 1974.

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Exhibit 4B Sample Closing Agreement-Nonamender for GUST, CRA and EGTRRA for Terminating Plans, Continued

This agreement is final and conclusive except:

a. the matter it relates to may be reopened in the event of fraud, malfeasance, or misrepresentation of material fact;
b. it is subject to the Code sections that expressly provide that effect be given to their provisions notwithstanding any other law or rule of law except Code section 7122; and
c. if it relates to any taxable period ending after the date of this agreement, it is subject to any law enacted after the agreement date that applies to that taxable period.

By signing, the above parties certify that they have read and agreed to the terms of this document.

ABC INC.

By:_____

Title:_____ Date Signed: _____

COMMISSIONER OF INTERNAL REVENUE

By:_____

Title:_____ Date Signed:_____

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