

# ERISA AUDIT REPORT

August 2009 Vol. 19, No. 1

## Message From The Firm

Welcome to the summer edition of our ERISA Audit Report for 2009! It's late August, which means our ERISA Department is about to enter a busy time of the year for helping plan sponsors and their advisors wrap up their employee benefit and welfare plan issues for 2009, and finalize their plans for 2010. It also means the 2010 Los Angeles Benefits Conference is fast approaching (January 20 - 22, 2010). This year's conference has particular significance for me, as I am an ASPPA Co-Chair of the conference. I welcome this opportunity. In fact, I have looked forward to it since I first started working on the LABC's Executive Committee back in 1997. Next year's LABC will mark my 16th year of participation in the conference, dating back to 1994 when I had my first speaking opportunity, which was on behalf of the IRS as the Western Region Walk-in Closing Agreement Coordinator.

As always, our ERISA Department continues to assist plan sponsors and their advisors with IRS audits, Department of Labor (DOL) investigations and PBGC investigations, and the correction of compliance defects under these agency's programs and procedures. We note that there has been a marked increase in our work in these areas over the last year, as it appears all of the government agencies have increased their enforcement activities and are taking somewhat of a harder line on correction methodologies and related costs, as well as the imposition of penalties.

In our first article, Marty Heming and I discuss a case involving multiple plans and multiple plan sponsors, all of which had come under audit by the same IRS revenue agent. Each of the plan sponsors believed it was operating an independent retirement program, so a fair amount of concern broke out when the IRS determined that the plan sponsors were all part of the same affiliated service group and, therefore, the retirement plans had to be

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## Audit CAP as a Dispute Resolution Technique

By Marty Heming, Esq. ([MartyHeming@Reish.com](mailto:MartyHeming@Reish.com)) and  
Nick White, Esq. ([NickWhite@Reish.com](mailto:NickWhite@Reish.com))



If during an IRS audit of a qualified plan the Service discovers one or more operational failures (e.g., failures to operate the plan in accordance with its written terms), the agent will generally offer to resolve the defects under the Audit Closing Agreement Program ("Audit CAP"). While Audit CAP requires the payment of a monetary

sanction that can be substantial, depending on the facts and circumstances of the case, there is flexibility under the program to negotiate both the amount of the sanction and – more importantly for purposes of this article – the methodology for correction.

Audit CAP is currently described in Revenue Procedure 2008-50 (the "Rev. Proc."), which contains the consolidation of the IRS' remedial programs – known as the Employee Plans Compliance Resolution System or "EPCRS" – for tax-qualified plans under Internal Revenue Code (the "Code") §401(a), Code §403(b) arrangements, SEPs and SIMPLE IRA plans. Audit CAP is available to correct any operational failure, provided the defect does *not* involve a diversion or misuse of plan assets, or an abusive tax avoidance transaction, for which correction rules outside of EPCRS apply.

Under Audit CAP, the plan sponsor has the ability to avoid plan disqualification by correcting operational failures to the satisfaction of the IRS agent, in accordance with the correction guidelines outlined in EPCRS, and by paying the IRS a monetary sanction. The sanction is a negotiated amount, based on a percentage of the "maximum payment amount" or MPA. The MPA is equal

to the total of the additional income taxes that would be payable if the plan were disqualified, and consists of each of the following:

- i) the additional tax that would result from the employer losing its deduction for contributions to the plan, to the extent the contribution is not vested for the plan participants;
- ii) the additional tax that would result from the trust having to recognize any earnings as income; and
- iii) the additional income tax that would result from participants recognizing as income the vested portion of the accrued benefits, as if they were immediately distributed.

Each of the above taxes is calculated for the tax years still open under the applicable statute of limitations, plus applicable penalties and interest. The percentage of the MPA ultimately imposed as a sanction is a negotiated amount between the agent and the taxpayer's representative based on, among other things, a list of non-exclusive mitigating factors provided by the IRS in the Rev. Proc.

Again, while the ability to negotiate the sanction under Audit CAP is important and has the potential for providing tremendous cost savings, the focus of this article is on the ability to negotiate the method of correction under Audit CAP, and how this can be a powerful tool in resolving disputes that arise in the context of a plan audit. This is highlighted by the following case study, which concerns a recent matter handled by our firm.

The case involves an audit of both our client's defined benefit plan (the "DB Plan") and a Code §401(k) plan (the "401(k) Plan") (collectively, the "Plans"). We were hired

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# Disclosures Required in DOL Settlement



*By Bruce Ashton, Esq. (BruceAshton@Reish.com)*

In 2007, the DOL released a proposed regulation under ERISA Section 408(b)(2) that would have required advance disclosure of service provider compensation and potential conflicts of interest to a “responsible plan fiduciary” and the use of written service agreements. After a comment period and public hearings, the DOL finalized the regulation in the fall of 2008 and submitted it to the Office of Management and Budget (OMB) for approval. (This is the final step in the process for approving all federal government regulations.) The OMB failed to act on the submission and with the change of administration from President Bush to President Obama, the regulation was withdrawn by the DOL and remains in limbo. As a result, there is still no mandate for service providers (with a few special exceptions) to use written agreements or make advance fee and conflict disclosures.

Notwithstanding this absence of the regulation, the DOL is using its enforcement authority to impose these requirements on service providers. Consider the following example.

Our client (TPA) is a recordkeeper and third party administrator, but the plan assets are custodied by a third party. In 2007, TPA determined that it could save its clients 25 basis points a year by switching to a different custodian. The new custodian offered to help defray some of TPA’s costs in making the conversion and, after the conversion was complete, began to send TPA revenue sharing payments based on the assets held by the new custodian. TPA had not negotiated for and was unaware that it would be receiving these payments. The principal of TPA consulted with us and asked how they should handle these funds. After some discussion, he decided that the funds would be remitted to the TPA’s clients.

At roughly the same time, the DOL began an investigation of a plan served by TPA. In the course of that investigation, the

DOL discovered the revenue sharing payments that had gone to TPA and opened an investigation of TPA. After a lengthy investigation, including several interviews with the principal of the TPA, the DOL concluded that the revenue sharing payments were plan assets, that TPA had failed to remit the payments to its clients on a timely basis and thus owed interest on this amount and that the cost-reimbursement payments made by the custodian constituted impermissible compensation to the TPA. Rather than engage in a lengthy dispute with the DOL, our client acquiesced and paid the additional amounts to its plan clients.

The DOL insisted that the TPA enter into a settlement agreement. Initially, we objected on the basis that it would subject TPA to the 20% penalty under ERISA Section 502(l), which provides that in the case of a fiduciary breach or knowing participation in such a breach, the DOL “shall assess a civil penalty” equal 20% of the “applicable recovery amount.” That amount is the amount recovered from a fiduciary or other party “pursuant to a settlement agreement with the [DOL]” or through litigation.

The DOL finally agreed that it would not impose the penalty so long as the TPA agreed to use a written service contract with its clients and, prior to entering into such a contract, to make disclosures regarding its compensation and potential conflicts of interest. In essence, the DOL imposed through the enforcement process the same requirements that would have been imposed under the 408(b)(2) regulation. Since TPA already used a written service contract and since it was already fully disclosing its compensation, remitting the revenue sharing to the plans for allocation to participant accounts and disclosing potential conflicts of interest, our client was happy to agree to the settlement and the matter was closed without further action.

We are seeing heightened enforcement activity by the DOL against service providers – often in tandem with the SEC where the service provider is a broker-dealer or registered investment adviser – and we

## Firm Message

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tested for coverage, participation and benefits as if the companies were a single employer. This case highlights the flexibility that may be available under the Audit Closing Agreement Program and how it can be used to bring about a good result, provided you have the experience and creativity to take advantage of the opportunities presented.

In our second article, Bruce Ashton discusses a DOL investigation that highlights an interesting issue regarding the much-talked-about proposed regulations under ERISA §408(b)(2). That is, notwithstanding the fact that the DOL withdrew the proposed regulations, it is still using its enforcement authority to impose the requirements on service providers. You’ll be interested in reading Bruce’s article to see how this is being accomplished.

In our third article, Heather Abrigo addresses a real hot button right now in the retirement plan world—that is, what appears to us to be the often arbitrary and greatly disproportionate penalties being assessed under Internal Revenue Code §6707A, ostensibly to curb abusive tax avoidance schemes. As Heather explains, it appears Congress is becoming increasingly concerned about the application of these penalties, and some relief may be on its way.

In our final article, Marty discusses a case that highlights what a powerful tool the IRS’ Self-Correction Program (SCP) can be, particularly in the context of an IRS audit of the plan. That’s right, notwithstanding the fact that a plan is under audit, you may still be able to self correct an operational failure, provided certain conditions exist and you know how to use them. Marty’s case also highlights how SCP can be used as an effective alternative to the correction methodologies available under an IRS closing agreement.

As always, we welcome your comments and questions. Please let us know if we can be of assistance to you and/or your clients.

Nick White  
NickWhite@Reish.com

anticipate that the DOL will continue to use its investigations as a vehicle for ensuring that the disclosures it deems appropriate are being made by service providers – at least until a regulation mandating disclosure becomes final. ❖

## The §6707A Penalty Nightmare: Is Relief on the Horizon?



*By Heather Bader-Abrigo, Esq. (HeatherAbrigo@Reish.com)*

Currently, the Internal Revenue Service (“IRS”) has the discretion to assess hundreds of thousands of dollars in penalties under §6707A of the Internal Revenue Code (“Code”) in an attempt to curb tax avoidance shelters. This discretion can be applied regardless of the innocence of the taxpayer and was granted by Congress. It works so that if the IRS determines you have engaged in a listed transaction and failed to properly disclose it, you will be subject to a potentially draconian penalty regardless of any other facts and circumstances concerning the transaction. For some, this penalty has been assessed at almost a million dollars and for many it is the beginning of a long nightmare.

However, there is some relief in sight. If legislation currently pending in Congress is passed, relief could be granted and this nightmare could end for many taxpayers. Further, on July 6, 2009, Commissioner Shulman of the IRS sent a letter to Honorable John Lewis that he is “concerned that because the current statute applies uniformly without exceptions and without regard to the amount of tax in question, some taxpayers are caught in a penalty regime that the legislation did not intend.” Commissioner Shulman has agreed that in light of the current legislation, the IRS “will not undertake any collection enforcement action through September 30, 2009, on cases where the annual tax benefit from the transaction is less than \$100,000 for individuals or \$200,000 for other taxpayers per year.”

Let us provide an example of the impact of this penalty. One of our clients requested our assistance in connection with the IRS audit of their 412(i) plan. Pursuant to a settlement with the IRS, the 412(i) plan was converted into a traditional defined benefit plan. All of the contributions to the 412(i) plan would have been allowable if they had initially adopted a traditional defined benefit plan. Based on our negotiations with the IRS agent, the audit of the plan

resulted in no income and minimal excise taxes due. This is because as a traditional defined benefit plan, the taxpayers could have contributed and deducted the same amount as a 412(i) plan.

When our client thought it was close to concluding the audit, they received a notice from the IRS. The IRS assessed our client penalties under §6707A of the Code in the amount of \$900,000.00. This penalty was assessed because our client allegedly participated in a listed transaction and allegedly failed to file the Form 8886 in a timely manner. Essentially, once the assessment is made, in most cases it is non-negotiable with the IRS agent who has imposed it and the only recourse is to appeal the assessment with IRS Appeals Office. Upon exhaustion of all administrative remedies with the IRS Appeals Office, the IRS has taken the position that there is no Tax Court jurisdiction. Thus, the only recourse is to pay the penalty and apply for a refund with the District Court.

Another client of ours never received the letter assessing the §6707A penalty and was still in the midst of the 412(i) audit when he heard a knock at his office door. An IRS collections officer showed up at his office to make “payment arrangements” on a \$200,000 §6707A penalty. We successfully worked to have all collections activities rescinded and provide us with more time to appeal the assessment of the §6707A penalty with IRS Appeals.

Another client of ours had entered into the Global Settlement Initiative under IRS Announcement 2005-80 per the advice of previous counsel. Under that settlement, he unwound his plan, paid all the income taxes and penalties. After signing the Closing Agreement, he was sent a letter that assessed the §6707A penalty in the amount of \$600,000. He was over 65 years old and after being denied his appeal with the IRS Appeals Office, he was forced to use all of his savings and retirement funds to pay the penalty. Is this truly what Congress imagined in 2004 when it gave the IRS the tools to assess this penalty?

The issue of the harsh impact this penalty is having on taxpayers was addressed by the National Taxpayer Advocate’s General Report to Congress. In the 2008 National Taxpayer Advocate Annual Report to Congress, the National Taxpayer Advocate recommended to Congress to “[m]odify Internal Revenue Code §6707A to Ameliorate [its] Unconscionable Impact.” The National Taxpayer Advocate acknowledged the “penalty is having unconscionable and possibly unconstitutional impact on taxpayers who have done nothing wrong.” This is because of the disproportionate penalties to the “abuse” and the fact that upon assessment the penalty cannot be appeal with the Tax Court.

The National Taxpayer Advocate further stated that “this penalty be imposed without regard to culpability may have the effect of bankrupting middle class families who had no intention of entering into a tax shelter.” Further, the US Chamber of Commerce in their statement to The Committee On Small Business Of The United States House Of Representatives called for a moratorium on §6707A penalties. The US Chamber of Commerce recommended an “immediate moratorium on the assessment and collection of the IRC Section 6707A penalty until the statute can be thoroughly reviewed and recommendations can be made to carry out the intention of Congress without the disproportionate and probable unconstitutional impact of current law on small businesses and their owners.”

It appears that Congress is now becoming concerned about the application and severity of the §6707A penalty, as evidenced by the most recent bill introduced by Senator Nelson. On April 1, 2009, Senator Nelson of Nebraska introduced Senate Bill 765, which would amend the Code to provide for: (i) a reasonable cause exception to §6707A of the Code; (ii) a proportionality requirement between the amount assessed under §§6707A and 6662A of the Code; and (iii) a retroactive effective date for any assessment on or after January 1, 2008. The bill was read and now resides with the Committee on Finance. On April 28, 2009, Representative Donnelly of Indiana introduced H.R. 2143, which mirrored Senate Bill 765 and which has since been referred to the Committee on Ways and

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## Self Correction After Audit



*By Marty Heming, Esq. (MartyHeming@Reish.com)*

Revenue Procedure 2008-50 (the “Rev. Proc.”) permits the self correction of any operational failure (e.g., failures to follow a plan’s written terms) under the IRS’ Self Correction Program (“SCP”), provided the appropriate corrective action is taken by the end of the second plan year following the plan year in which the defect occurred, and before the IRS initiates an audit of the plan. If, however, an operational failure is *insignificant*, it can be corrected after the two-year correction period and even if the plan is under audit by the IRS.

In order to be eligible for self correction, the employer must have in place — at the time the error occurred — practices and procedures which, if followed, would have prevented the error. This is true regardless of whether the defect is being corrected under the two-year correction period or outside of that period, as an insignificant defect, because “established practices and procedures” is a threshold eligibility requirement under SCP. If an employer is attempting to use self correction after the time the plan has come under audit by the IRS, it will also have to be able to establish that the defect is “insignificant” under all the facts and circumstances of the case. The determination of whether operational failures are insignificant is left to the discretion of the IRS, using a series of non-exclusive factors listed in Section 8.01 of the Rev. Proc.

Recently, we handled an audit of an employer’s 401(k) plan, which involved the employer’s failure to use W-2 compensation in violation of the plan’s written terms. During 2005, 2006 and 2007, in operation participant elective deferrals were based on a percentage of compensation that did not include taxable fringe benefits, such as auto allowances. As a result, some participants had deferral and matching contribution made to their accounts that were less than required under the plan’s terms, resulting in operational failures.

The employer had two options in this instance for addressing the correction of the defects. First, it could have attempted to resolve them by proposing to retroactively amend the plan to conform its terms to its operation. This would have required the employer to argue to the IRS that it was always its intent that the plan definition of compensation exclude fringe benefits for purposes of determining plan benefits, and this was communicated not only to the plan participants, but to the professional third-party administrator who drafted the plan document. And, notwithstanding its instructions, the administrator failed to draft the plan document to contain the exclusion for fringe benefits for purposes of determining compensation. Based on these arguments, the employer could conclude that the plan contained a “scrivener’s error” (a drafting mistake), for which the appropriate method of correction is to retroactively amend the plan document to match the employer’s intended and consistent operation of the plan, and the understanding of plan participants. If the IRS agreed to all this, that agreement would have to be formalized under the IRS’ Audit Closing Agreement Program (“Audit CAP”), which would require the payment of a monetary sanction. The advantage of resolving the defect through a retroactive amendment to the plan is it avoids having to put additional money in the plan, to make the participants whole for the under contributions to their accounts. The primary obstacle faced in securing the IRS’ agreement to correct on this basis is proving that the operation of the plan matched the employer’s intent and the understanding of the plan participants. The IRS does not easily give away the retroactive amendment fix in this situation, without substantial evidence of a scrivener’s error. And, of course, Audit CAP requires the payment of a sanction, which can be substantial depending on the facts and circumstances of the case.

As an alternative to correction through a retroactive amendment under Audit

CAP, the employer could choose to simply readminister the plan in accordance with its written terms. That is, agree to redetermine benefits based on compensation including fringe benefits and contribute the additional benefits amounts to participant accounts, adjusted for earnings to take into account the delay in making those contributions. This type of correction is available under SCP, and without the payment of a sanction, and this is how the employer in this case preferred to correct the operational defect. Specifically, the CEO informed us that “I would rather pay the employees than [a sanction to] the IRS.”

However, the plan was under audit by the IRS. This means SCP was available only if we could establish the employer had in place at the time the defects occurred practices and procedures reasonably designed to facilitate compliance with the qualified plan rules, and that the operational failures – in the aggregate – were insignificant. In our letter to the IRS, we addressed these issues making the following arguments:

1. The plan at all times had in place established practices and procedures which, if followed, would have avoided the operational errors that occurred. We gave a specific description of the employer’s long-standing and consistent practices and procedures, and explained how they were reasonably designed to facilitate compliance with the qualified plan rules.
2. The error in this case was the product of ineffective communication between the employer and its advisor. It involved an isolated instance of human error, not caused by a lack of established practices and procedures.
3. The failure to use W-2 compensation without reduction for fringe benefits was the only operational failure in any of the affected plan years.
4. The defect existed in only three plan years.

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## Audit CAP

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after the IRS audit had begun and the revenue agent started raising issues.

The Plans were sponsored by Dr. X and his professional service corporation (“PC”). Dr. X owned 100% of the PC and 30% of ABC Partnership (“ABC”). The remaining 70% of ABC was owned by four other doctors, through their professional corporations, each of which sponsored tax-qualified plans that were under audit by the same revenue agent auditing the DB Plan (we only represented Dr. X and the PC).

ABC’s employees were obtained through a payroll leasing company, which sponsored a 401(k) plan (the “Leasing Company Plan”). The employees were eligible to participate only in the Leasing Company Plan. Dr. X was the only participant in the Plans.

Immediately, the IRS revenue agent focused in on whether the PC and ABC were part of an affiliated service group, as described in Code §414(m). Initially, Dr. X and his advisors believed that such an affiliated service group did *not* exist. Ultimately, however, it was determined that their conclusion in this regard was incorrect. This is because, under Code §318(a)(3)(A), ABC was deemed to own all of Dr. X’s stock in the PC, even though Dr. X was only a 30% owner of ABC. If ABC had been a corporation, the result would have been different (due to Dr. X’s minority interest in ABC). Based on ABC’s 100% ownership of the PC, ABC and the PC were an affiliated service group of the “A Org” variety. In a nutshell, this determination meant that the ABC employees were eligible for benefits under the 401(k) Plan and the DB Plan, and since they had not been provided with those benefits in accordance with the Plans’ terms, each of the Plans had incurred an operational failure. The issue then became how to structure the least expensive methodology for correction – this is, something substantially less than providing full, retroactive benefits under each of the Plans.

At our suggestion, Dr. X was able to obtain statements from each of the leased employees confirming that they did not want to make any elective contributions to the 401(k) Plan. Based on this documentation, we requested that the IRS forgo any corrective action by reason of failing to provide the employees benefits under the 401(k) Plan. That is, since none of the employees would have elected to

make elective deferrals under the 401(k) Plan, there was no reasonable basis upon which to impose on the PC an obligation to make corrective contributions on the employees’ behalf. We argued that to require corrective contributions in this instance would amount to a windfall to the employees, and there is nothing under EPCRS’ corrective principles that is consistent with providing such a result. The agent agreed with our analysis, and granted our request for a “no-correction” method of correction with respect to the defect of failing to include the employees in the 401(k) Plan.

With respect to the DB Plan, we argued to the revenue agent that since the employees were providing services to ABC on behalf of each of the partners, the partners were sharing the employees; therefore, the PC should be liable for corrective benefits to the employees based only on that portion of their compensation attributable to the work they did for Dr. X. The IRS rejected this proposal. Rather, the revenue agent insisted that the DB Plan take into account the entire compensation paid to the employees for purposes of calculating the corrective amount to be contributed to the DB Plan. That is, it was the revenue agent’s intent to hold each of the doctors’ plans liable for the benefits attributable to the entire compensation of each employee.

Notwithstanding the revenue agent’s position that the employees’ entire compensation must be taken into account for purposes of calculating corrective contributions to the DB Plan, and that each of the doctors’ plans was liable for the correction, the revenue agent said she was not going to require any of the employees receive more than the maximum benefit payable under the doctor’s plan with the richest benefit formula. Based on this apparent willingness on the part of the revenue agent to avoid a windfall to the employees, we worked with the Dr. X’s actuary in developing a proposed method of correction that would require Dr. X to make a contribution to the 401(k) plan in the amount needed to pass the safe harbor for multiple defined contribution and defined benefit plans, using the defined benefit plan with the greatest benefit formula. We then put forth a number of arguments explaining why this made practical sense under all the facts and circumstances of the case. That is, we explained how the proposed method of correction avoided unintended windfall in benefits, while putting the employees in the position they would have been in if the doctors and their advisors had been aware that the affiliated service group rules applied.

Ultimately, the revenue agent saw the wisdom in our logic and approved our proposal. We then negotiated, outside of the retirement plans, a cost-sharing arrangement among the doctors with respect to the corrective amount to be contributed to the 401(k) plan. (The amount of the IRS Audit CAP sanction is still being negotiated.) So, in the end, we were able to provide Dr. X with essentially the same correction methodology we had first proposed to the IRS.

This case is important for several reasons. First, it highlights the value in being able to present practical solutions to the IRS, in a manner that is acceptable to the revenue agent – this is how we were able to ultimately obtain the correction methodology that was initially rejected by the IRS. Second, this case illustrates how carefully choosing the correction methodology can produce good results apart from the plan. Specifically, the correction in this case permitted the doctors and their advisors avoid wasting time (and potentially money) trying to figure out who was at fault for not getting an advance ruling the IRS on whether an affiliated service group existed among the doctors and ABC. Finally, the case highlights the value of working with creative and experienced actuaries – ERISA lawyers often need help in determining the lowest cost of correction. We are fortunate to have many long-standing relationships with excellent actuaries and third-party administrators. ❖

## §6707A

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Means. We hope that the pending legislation will prove successful and provide some much needed relief to those taxpayers who are faced with this penalty.

If you are subject to the §6707A penalty or are currently engaged in an audit with the IRS that involves a listed transaction, we strongly recommend that you seek advice from a tax professional. From the assessment of the penalty through the appeals process, there are many traps that only a tax professional with experience in these matters can assist you competently. ❖

## Correction

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5. For all affected plan years, the number of participants impacted by the defect relative to the total number of participants was only about 23% (42 participants out of a total of 182 participants).
6. For all years the number of participants affected relative to the total number that could have been affected was 42 out of 169, or about 25%.
7. Only a small percentage of annual contributions was involved in the violations. Annual contributions were running about \$650,000 in each of the 3 years. In 2005, the total correction amount was approximately \$18,000. This amounts to 2.7 percent of the annual contribution amount. In 2006 and 2007, the total correction amount was approximately \$27,000, which equals 4% of the annual contribution amount.
8. The defect involved only a small percentage of plan assets. Specifically, the plan assets for 2005, 2006 and 2007 were approximately nine million dollars. In 2005, the error resulted in approximately \$13,500 in missed deferrals and \$4,400 in missed matching contributions, for a total corrective contribution amount of \$18,000 or 2/tenths of one percent of the plan assets. In 2006, the error resulted in approximately \$20,000 in missed deferrals and \$6,500 in missed matching contributions, for a total corrective contribution amount of approximately \$27,000 or 3/tenths of one percent of the plan assets. Finally, in 2007 the defect resulted in approximately \$20,000 in missed deferrals and \$6,800 in missed matching contributions, for a total corrective contribution amount of \$27,000 or 3/tenths of one percent of the plan assets.
9. The employer agreed to make complete correction of the operational violation for all years during which it existed. Specifically, the employer agreed to make a full corrective contribution for all affected employees, based on their compensation determined without any exclusion for fringe benefits, plus related earnings based on the average rate of return for all plan investments for the applicable year. In addition, the employer agreed to make the matching contributions that would have applied in each instance. We highlighted the fact that this proposed correction methodology was more generous than the 50% qualified nonelective contributions (QNECs) contemplated by the Rev. Proc. for correcting the defect of excluding an eligible employee. Furthermore, the proposed correction provides what amounts to a “windfall” to the affected employees, because the employer is making the contribution that otherwise would have been made out of the employees salary.

The defect resulted from a “good faith” violation – that is, the employer believed in good faith that the plan’s terms reflected its intent and instructions to the professional third-party administrator that benefits be determined based on compensation excluding certain fringe benefits, and the employer consistently operated the Plan on this basis.

Ultimately, based on the above arguments, the IRS approved the use of self correction in this instance, notwithstanding the fact that the plan was under examination, and agreed to close the case without the imposition of what could have been a substantial sanction.

This case is important to you for two reasons. First, it serves as a reminder to consider self correction as an alternative to Audit CAP and its risk of a large sanction. Secondly, it emphasizes that the negotiation of a settlement with the IRS often places a premium on creativity in selecting an appropriate correction methodology, and also in making the arguments necessary to support it. ❖

## 2010 Los Angeles Benefits Conference

Nick White is a Co-Chair of the 2010 Los Angeles Benefits Conference, to be held at the Universal Hilton on January 20th through 22nd. Each year the Conference provides an unparalleled educational experience in terms of offering practical information about what plan sponsors and their advisors must know. The program focuses on educating attendees about current regulatory, legislative, administrative and actuarial topics. Each panel of speakers is made up of top-notch, experienced private sector professionals and almost all of the panels feature high-ranking government officials, to whom you will have direct access throughout the Conference. Here are just a few of the Conference highlights:

- *Keynote Speaker:* Sarah Hall Ingram, New Commissioner of TE/GE
- *Washington Update* with Brian Graff and high-ranking government officials
- *NEW!* A session focusing on the business of being a TPA/actuary
- *NEW!* Separate DB and DC sessions focusing on fiduciary responsibilities in a troubled economy
- *NEW!* Post-conference sessions with the government – bring all the questions you didn’t get to ask to this intimate setting!
- *ERISA Litigation Update* with high-ranking government attorneys & top-notch private sector litigators
- *More Actuarial Sessions* than ever before!
- *Section 403(b) Arrangements* with Bob Architect

We strongly urge you to sign up today to take advantage of the unique opportunity offered by the LABC. For more information, please go to the following link: <http://www.asppa.org/labc>.

## Around the Firm

**Speeches:** On May 7th, **Bruce Ashton** presented “Your Worst Nightmare: Meet the Attorney Who Sues Financial Advisors (And One Who Defends Them)” to the First Mercantile seminar in Memphis, TN. On May 19th and 20th, **Jason Roberts** co-presented “Market Volatility and Your 401(k): Meeting your Responsibilities and Managing your Liabilities in today’s Uncertain Environment” at the Sullaway Nakashima Group of Wachovia Securities luncheon in Escondido and Carlsbad. On May 28th, **Marty Heming** presented “Case Studies: IRS Audits & Voluntary Correction—EPCRS 2008-50 & the ERISA Regulation that Might Have Been—408(b)(2)” to the CPA and Law Society of Santa Barbara County in Santa Barbara. On June 3rd-4th, **Jason** presented the topics “Disclosure and Reporting Requirements Post 408(b)(2)” and “Adviser Consents” to the Investment Fiduciary Leadership Council, SoCal Fiduciary Roundtable in Irvine. He was also a panelist at the Plansponsor 2009 Plan Designs Conference at the “Washington Update” workshop on June 3rd in Chicago, IL.

**Quotes:** In the June 24th issue of *MarketWatch*, **Jason** was quoted in the article “Bill Advances to Require 401(k) Fee Disclosure.” He was also quoted in the article “Insurance-Affiliated Brokers Face Major Changes Under Obama Plan,” published on *InvestmentNews*, on June 28th.

**Articles:** In the May and June issues of the *Plan Sponsor* magazine, **Fred Reish** wrote columns entitled “Automatic Piloting: Re-Inventing 401(k) Plans as Retirement Plans- Part III” and “Long Lives and Lessons Learned,” respectively. In the June issue of *Plan Fix-It Handbook*, **Nick White** wrote the article “Safe Harbor 401(k) Plans: Can the ‘Promise’ To Make Contributions Be Broken?”

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