March 19, 2015

Mr. Rob Choi
Director, Employee Plans
Internal Revenue Service
999 North Capitol Street, NE
Washington, DC 20002

RE: Loan Corrections under EPCRS

Dear Mr. Choi:

The American Society of Pension Professionals & Actuaries ("ASPPA") is writing in response to your request for specific recommendations regarding operational failures related to participant loans that should be eligible for correction under the Self-Correction Program ("SCP") component of the Employee Plans Compliance Resolution System ("EPCRS"), and what correction methods should be prescribed for each loan failure.

ASPPA is a national organization of retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA members are retirement professionals of all disciplines including consultants, administrators, actuaries, accountants, and attorneys. ASPPA is particularly focused on the issues faced by small- to medium-sized employers. ASPPA is now part of the American Retirement Association whose total membership of more than 17,000 retirement plan professionals is diverse but united by a common dedication to the employer-based retirement plan system.

Summary

The following is a summary of ASPPA's recommendations, which are described in greater detail in the **Discussion** section which follows.

ASPPA recommends that the Service issue guidance expanding the operational failures related to participant loans to be corrected under the SCP component of EPCRS. ASPPA specifically recommends that SCP be expanded for loan failures that are otherwise eligible for correction under SCP to permit (i) correction of operational errors related to plan loans in a manner that will avoid reporting the loan as a deemed distribution, and (ii) reporting deemed distributions under IRC §72(p) on a Form 1099-R for the year of correction (without a Voluntary Correction Program ("VCP") submission).

ASPPA recommends that, to the extent broad expansion of SCP eligibility for plan loan failures is not provided, at a minimum, SCP should be expanded to permit correction of the following operational loan errors, provided such error is otherwise eligible for SCP:

- Form 1099-R reporting relief;
- Loans with repayment errors;

- Loans that exceed the maximum repayment period;
- Loans that exceed the maximum loan amount;
- Loans that exceed the maximum permitted number of loans outstanding; and
- Loans made without spousal consent when required by the plan's terms.

Discussion

Plan loans play an important role in the design of retirement plans. It has been widely reported that the U.S. population is facing a retirement crisis and individuals need to save more for retirement. The importance of the employer-based retirement system in achieving that objective cannot be understated. Employees who have access to workplace retirement plans are significantly more likely to save for retirement.[1] However, even within the employer-based retirement system there are barriers to employee-participation. Studies have shown plans that allow participant loans have a higher proportion of employees participating than plans that do not permit loans.[2] Therefore, to encourage even broader participation in retirement plans, ASPPA believes it is necessary to lessen the burdens associated with offering participant loan programs.

I. Broad Expansion of SCP for Plan Loan Failures

ASPPA appreciates the Service's efforts to continue expanding the corrections available under EPCRS. Recognizing the extensive use of loan programs and the importance of those programs to encourage participation in retirement plans, ASPPA believes the Service should broadly expand the operational failures with respect to plan loans that may be corrected under SCP.

Loan programs are more often provided by sponsors of medium and large plans.[3] As a result, the lack of a self-correction option presents a significant burden for many plan sponsors. Currently, even the most insignificant plan loan error can result in the sponsor being faced with the option of either burdening the participant by reporting the loan as a taxable deemed distribution (and related reporting obligations), or paying a VCP fee that can range as high as $12,500 (plus the costs associated with making the submission) to avoid that result.[4] The burden of the first option is multiplied by the fact the loan must be reported as a deemed distribution in the year of default. This may require a participant to amend a prior year's tax return to report and pay additional taxes, often because of an inadvertent systems error that was not the fault of the participant.[5] For

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[1] "Workers who participate in, and contribute to, a retirement savings plan at work (44 percent) are considerably more likely to have saved at least $50,000 than those who are offered a plan but choose not to participate (13 percent) or are not offered a plan (15 percent). Participating workers are much less likely than others to report having saved less than $10,000 (18 percent vs. 58 percent who choose not to participate and 54 percent who are not offered a plan)." **2014 RCS Fact Sheet #6**, EBRI. http://ebri.org/pdf/surveys/rcs/2014/RCS14.FS-6.Prep-Ret.Final.pdf.

[2] *See, e.g.,* GAO Report "401(k) Pension Plans: Loan Provisions Enhance Participation But May Affect Income Security for Some," October 1, 1997. Although plan loans might impair income security for certain participants, it is important to note that only one-fifth of participants who have access to a plan loan take advantage of the loan opportunity and median loan balances are routinely below $4,000. EBRI.org, *Issue Brief*, December 2014, No. 408.

[3] Although slightly more than half of all 401(k) plan sponsors offer a loan program, ninety-two percent of plans with more than 10,000 participants included a loan provision, compared with 32 percent of plans with 10 or fewer participants." EBRI.org, *Issue Brief*, December 2014, No. 408. *See also id.* Figure 44.

[4] *See* Rev. Proc. 2013-12, I.R.B. 2013-4, 313, Section 6.07(1), 12.

[5] *See id.*

insignificant operational errors and other loan failures that are discovered and corrected quickly, this result is cumbersome and can discourage employers from continuing to maintain a loan program. SCP should be available as an alternative correction for these errors to encourage correction and lessen the burdens of maintaining the loan program.

ASPPA believes the safeguards inherent in the eligibility criteria for SCP adequately protects the Service's interest in ensuring administrators operate their plans in accordance with the plan criteria. Further, because loan corrections will be significantly less burdensome if discovered and corrected quickly, broadening the SCP eligibility criteria will facilitate and make more likely voluntary, timely, and efficient correction of plan loan failures

ASPPA recommends that SCP be expanded for loan failures that are otherwise eligible for correction under SCP to permit (i) correction of operational errors related to plan loans in accordance with the correction principles already set forth in EPCRS for VCP corrections, and (ii) reporting of deemed distributions under IRC §72(p) on a Form 1099-R for the year of correction.

II. Specific Loan Failures

In the absence of a broad expansion of SCP with respect to plan loan failures, SCP should, at the very least, be expanded to permit correction of the following loan failures (assuming the operational failure is otherwise eligible for correction under SCP).

a. Relief for Tax Year Deemed Distribution is Recognized

Errors with respect to plan loans often occur despite the administrator's best efforts at administering the plan's loan procedures. Although the administrator may discover the error very quickly, the current rules for SCP require the plan to report the loan as a deemed distribution in the year the defect arose. The only way to potentially avoid recognizing a deemed distribution in the defect year is for the plan sponsor to request relief through a formal VCP application.[6] Because the cost of a VCP submission may be discouragingly expensive to the plan sponsor, particularly to correct a single error, the participant is often left with the burden and expense of amending a prior year's tax return to report the tax consequences of the defective loan. A self-correction option that would permit the deemed distribution's taxation to be recognized in the year the error is discovered would avoid this hardship to participants who are often not at fault. It would also encourage the plan sponsors to continue to offer and maintain plan loan programs which ultimately result in higher savings rates by participants.

ASPPA recommends that self-correction of plan loan errors that otherwise meet the requirements for SCP should include deferred recognition of the tax consequences to the year in which the employer discovers the error, without the need to file a formal VCP application.

[6] *See id.* at Section 6.07(1).

b. Loans with Repayment Errors

Miscommunications in transmitting loan information or a loan input error when a loan is established in payroll are a common occurrence in our industry, even with employers and plan providers who have prudent loan origination procedures in place. These inadvertent and occasional errors may cause a failure to establish the correct amount of payroll deduction or to establish a payroll deduction timely. In addition, employee events such as leaves of absence, changing positions within the company (i.e. moving from one payroll cycle to another), changing from full-time to part-time employment, or paying off another loan may be occasion for inadvertent errors. Examples would include not restarting repayments after a leave of absence, establishing loan payments on the wrong payroll cycle, or inadvertently stopping payroll deduction on an outstanding loan.

VCP provides that a failure to repay the loan in accordance with the loan terms where the terms satisfy IRC §72(p)(2) may be corrected in one of two ways.[7] First, the error may be corrected by requiring the participant to repay in a single sum the amount the participant would have paid if the failure had not occurred (plus interest).[8] Alternatively, the error may be corrected by reamortizing the outstanding balance of the loan, including accrued interest, over the remaining term of the loan or the period remaining if the loan had been amortized over the maximum period that complies with IRC §72(p)(2)(B), measured from the loan origination date.[9] Under VCP, the plan may use either or both methods in connection with the correction of a participant loan.[10] These VCP correction options should be permitted under SCP, particularly when the affected individuals are predominately non-highly compensated employees. The other requirements of SCP would minimize the potential for abuse if this change were made. The end result would be a significant improvement in voluntary compliance and timely reporting of defective loans.

ASPPA recommends EPCRS be modified to allow correction of the loan failures described above through SCP using one or more of the methods currently specified under VCP, provided (i) the participants affected by the failure were predominately non-highly compensated employees; and (ii) the failure otherwise meets the requirements for SCP.

c. Loan Exceeds the Maximum Repayment Period

The terms of a loan may inadvertently exceed the maximum repayment period permitted under IRC §72(p). This error may occur, for example, when a participant's loan is originally classified as a residential loan but is subsequently determined not to qualify as such.

VCP allows a plan to correct a repayment schedule that fails to comply with the maximum repayment period by reamortizing the loan balance over the remaining period of the loan that is equal to or less than the maximum period (e.g., five years from the original date of the loan).[11]

[7] *Id.* at Section 6.07(3).
[8] *Id.* at Section 6.07(3)(i).
[9] *Id.* at Section 6.07(3)(ii).
[10] Rev. Proc. 2013-12, I.R.B. 2013-4, 313, Section 6.07(3)(iii).
[11] *Id.* at Section 6.07(2)(c).

ASPPA recommends EPCRS be modified to allow correction of the loan failures described above through SCP using the methods currently specified under VCP, provided (i) the loans involved in the failure were issued predominately to non-highly compensated employees; and (ii) the failure otherwise meets the requirements for SCP.

d. Loan Exceeds Maximum Loan Amount

A plan also might inadvertently permit the amount of a loan to exceed the maximum amount permitted under IRC §72(p). This error may occur, for example, due to a math error, a change in vendors, or in the case of a 403(b) plan, a communication error between service providers when the plan is on multiple platforms.

VCP allows a plan to correct a loan in excess of the maximum amount by seeking immediate repayment of the excess loan amount.[12] Any loan payments must be applied to the portion of the loan that did not exceed the maximum or to reduce the loan excess to the extent of interest thereon.[13] After the repayment, the loan may be reamortized to create a substantially level amortization of the remaining balance over the original loan period.[14]

ASPPA recommends EPCRS be modified to allow correction of the loan failures described above through SCP using the methods currently specified under VCP. In addition, ASPPA recommends that EPCRS be modified to permit plans (under both SCP and VCP) to correct such loans failures by reamortizing the balance of the loan that remains after seeking repayment of the excess loan amount over a period longer than the original loan period (provided such period does not end after the maximum loan period, measured from the date of the loan). ASPPA believes this is equitable in light of the requirement that the participant reimburse the plan for the excess loan amount. In all cases, the correction under SCP would be available only if (i) the loans involved in the failure were issued predominately to non-highly compensated employees and (ii) the failure otherwise meets the requirements for SCP.

e. Loan Exceeds Maximum Number of Loans Outstanding

Plans commonly specify a maximum numbers of loans that a participant may have outstanding at any time, or have other provisions that are more restrictive than IRC §72(p) (e.g., loan amount exceeds plan limit but under the IRC §72(p) limit). However, plans sometimes inadvertently permit participants to have loans that exceed the stated maximum number of loans or otherwise fail to comply with more restrictive plan terms. These errors may occur for many reasons, including a change in vendors, a miscommunication between plan sponsor and service provider, or in the case of a 403(b) plan a communication error between service providers when the plan is on multiple platforms.

EPCRS allows a plan that issues loans without a loan provision to correct the failure by retroactive amendment.[15] Such retroactive amendment can be limited to the loan erroneously issued.[16] Further, EPCRS generally allows employers to correct overpayment failures by

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[12] *Id.* at Section 6.07(2)(b).
[13] *Id.*
[14] *Id.*
[15] *See id.* at Section 4.05(2), Appendix B, Section 2.07(2).
[16] Rev. Proc. 2013-12, I.R.B. 2013-4, 313, Appendix B, Section 2.07(2)(a).

requesting a return of the funds with interest from the participant.[17] If after diligent efforts the plan participant does not repay the erroneous distribution, and the participant would be entitled to the funds at a later date, the employer need not reimburse the plan.[18] However, the amounts are not eligible for rollover and the distribution is taxable to the participant.[19]

ASPPA recommends EPCRS be modified to allow correction of the loan failures described above through SCP by one of three means: (i) retroactive amendment (including a retroactive amendment applicable only to the erroneously issued loan); (ii) immediate repayment by the participant of the amount of the erroneously issued loan; or (iii) treat the outstanding loan balance (or excess thereof as a result of a plan limit) as a deemed distribution in the year of correction. In all cases, the correction would require that (i) the loans involved in the failure were issued predominately to non-highly compensated employees and (ii) the failure otherwise meets the requirements for SCP.

f. Loan Without Required Spousal Consent

Loans to participants are most often secured with a portion (generally not to exceed 50%) of the participant's accrued benefit under the plan. Plans that are subject to IRC §401(a)(11) must obtain the consent of the participant's spouse to use the participant's accrued benefit as collateral for the loan. However, for various reasons, a plan might inadvertently fail to obtain the required spousal consent, for example, due to a change in vendors or incorrect records regarding marital status.

EPCRS generally provides that when spousal consent is required for a distribution but not obtained, the employer must notify the affected participant and spouse so that the spouse may provide spousal consent.[20]

ASPPA recommends EPCRS be modified to allow correction of the loan failure described above through SCP by: (i) obtaining spousal consent for the loan by affirmative or negative consent; (ii) repayment of the loan amount by the participant; or (iii) treat the outstanding loan balance as a deemed distribution in the year of correction. In all cases, the correction would require that (i) the loans involved in the failure were issued predominately to non-highly compensated employees and (ii) the failure otherwise meets the requirements for SCP.

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These comments are submitted on behalf of and were prepared by ASPPA's IRS Subcommittee, Frank Porter, QKA, QPA, Chair. If you have any questions regarding the matters discussed herein, please contact Craig Hoffman, ASPPA General Counsel and Director of Regulatory Affairs at (703) 516-9300.

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[17] *See id.* at Section 6.06(4).
[18] *Id*. at Section 6.06(4)(e).
[19] *Id.*
[20] *Id.* at Section 6.04(1).

Thank you for your time and consideration.

Sincerely,

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