

Part III--Administrative, Procedural and Miscellaneous

26 CFR 601.202: Closing agreements.

Rev. Proc. 99-13

SECTION 1. PURPOSE AND OVERVIEW

.01 Application of EPCRS to 403(b) Plans. This revenue procedure provides a comprehensive system of correction programs and procedures for an employer that offers a plan that is intended to satisfy the requirements of § 403(b) of the Internal Revenue Code (the "Code"), but that has failed to satisfy those requirements because of Operational, Demographic, or Eligibility Failures. This system permits an employer to correct these failures, and thereby provide its employees with retirement benefits on a tax-favored basis. This revenue procedure modifies and amplifies the Employee Plans Compliance Resolution System (EPCRS), set forth in Rev. Proc. 98-22, 1998-12 I.R.B. 11, to include specific programs and procedures relating to 403(b) Plans. In addition, this revenue procedure replaces the program described in Rev. Proc. 95-24, 1995-1 C.B. 694, which established the Tax Sheltered Annuity Voluntary Correction (TVC) program, and which was extended by Rev. Proc. 96-50, 1996-2 C.B. 370. Except as otherwise indicated in this revenue procedure, the specific provisions of EPCRS apply to 403(b) Plans.

.02 Overview of EPCRS. Pursuant to Rev. Proc. 98-22, as modified by this revenue procedure, the following programs comprise EPCRS for correction of failures with respect to a 403(b) Plan.

(1) APRSC: Self-correction. The Administrative Policy Regarding Self-Correction (APRSC), as described in Rev. Proc. 98-22, is a voluntary employer-initiated program that does not involve Service approval. Under APRSC, an employer that has compliance practices and procedures may correct Operational Failures, without paying any fee or sanction, including Operational Failures relating to contributions to a 403(b) Plan that are in excess of the § 415 limit or the § 403(b)(2) limit (the exclusion allowance). APRSC is described in Section 7 of Rev. Proc. 98-22, as modified by sections 4 and 5 below.

(2) TVC: Voluntary correction with Service approval. Under TVC, an employer or plan that is not Under Examination (as defined in Section 5.06 of Rev. Proc. 98-22) may pay a limited fee and receive the Service's approval for the correction in the form of a closing agreement with the appropriate Key District Office. TVC allows correction of Operational Failures, Demographic Failures, and Eligibility Failures that are within the jurisdiction of the EP/EO Division of the Key District Office, including a Plan of an Ineligible Employer. TVC is described in sections 4, 6, 7, and 8 below.

(3) Audit CAP for 403(b) Plans: Correction on audit. Audit CAP as described in Rev. Proc. 98-22 is expanded by this revenue procedure to cover closing agreements in connection with a 403(b) Plan that is Under Examination. Under Audit CAP for 403(b) Plans, if an Operational Failure that is not eligible for APRSC, a Demographic Failure, or an Eligibility Failure is identified with respect to a 403(b) Plan that is Under Examination, and the failure is corrected, the sanction imposed will bear a reasonable relationship to the nature, extent, and severity of the failure. Audit CAP for 403(b)

Plans is described in section 9 below (extending the program described in Sections 14 and 15 of Rev. Proc. 98-22).

.03 Request for comments. The Service specifically solicits comments or suggestions relating to the guidance provided in this revenue procedure. It is requested that comments or suggestions be submitted by May 2, 1999, addressed to CC:DOM:CORP:R (Rev. Proc. 99-13), Room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, comments may be hand-delivered between the hours of 8 a.m. and 5 p.m. to CC:DOM:CORP:R (Rev. Proc. 99-13), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may transmit comments electronically via the Service's Internet site at "http://www.irs.ustreas.gov/prod/tax_regs/comments.html".

SECTION 2. EFFECT OF EPCRS; RELIANCE

.01 Income taxes. If the applicable eligibility requirements are satisfied and the employer corrects a failure in accordance with the requirements of APRSC, TVC, or Audit CAP for 403(b) Plans, the Service will not pursue income inclusion for affected participants, or liability for income tax withholding, on account of the failure. However, the correction of a failure may itself result in income tax consequences to participants (for example, participants may be required to include in gross income distributions of Excess Amounts in the year of distribution).

.02 Excise and employment taxes. Excise taxes, FICA taxes, and FUTA taxes (and corresponding withholding obligations), if applicable, that result from a failure are

not waived merely because the failure has been corrected.

.03 Other taxes and penalties. See Section 6.04 of Rev. Proc. 98-22 for rules relating to other taxes and penalties.

.04 Reliance. Taxpayers may rely on this revenue procedure, including the relief described in section 2.01.

SECTION 3. DEFINITIONS

The following definitions apply for purposes of this revenue procedure.

.01 403(b) Plan. The term "403(b) Plan" means a plan or program intended to satisfy the requirements of § 403(b), including a Plan of an Ineligible Employer.

.02 Demographic Failure. The term "Demographic Failure" means, with respect to a 403(b) Plan, a failure to satisfy the requirements of § 401(a)(4), § 401(a)(26), or § 410(b) (as applied to 403(b) Plans pursuant to § 403(b)(12)(A)(i)).

.03 Eligibility Failure. The term "Eligibility Failure" means, with respect to a 403(b) Plan, any of the following:

- (1) A Plan of an Ineligible Employer;
- (2) A failure to satisfy the nontransferability requirement of § 401(g);
- (3) A failure to initially establish or maintain a custodial account as required by § 403(b)(7); or
- (4) A failure to purchase (initially or subsequently) either an annuity contract from an insurance company (unless grandfathered under Rev. Rul. 82-102, 1982-1 C.B. 62) or a custodial account from a regulated investment company utilizing a bank or an approved non-bank trustee/custodian.

.04 Excess Amounts. The term "Excess Amounts" means any contributions or allocations to a 403(b) Plan that are in excess of the limits under § 415 or § 403(b)(2) (the exclusion allowance limit) for the year.

.05 Operational Failure. The term "Operational Failure" means, with respect to a 403(b) Plan, any of the following:

- (1) A failure to satisfy the requirements in § 403(b)(12)(A)(ii) (relating to the availability of salary reduction contributions);
- (2) A failure to satisfy the requirements of § 401(m) (as applied to 403(b) Plans pursuant to § 403(b)(12)(A)(i));
- (3) A failure to satisfy the requirements of § 401(a)(17) (as applied to 403(b) Plans pursuant to § 403(b)(12)(A)(i));
- (4) A failure to satisfy the distribution restrictions of § 403(b)(7) or § 403(b)(11);
- (5) A failure to satisfy the incidental death benefit rules of § 403(b)(10);
- (6) A failure to pay minimum required distributions under § 403(b)(10);
- (7) A failure to give employees the right to elect a direct rollover under § 403(b)(10), including the failure to give meaningful notice of such right;
- (8) A failure to satisfy the limit on elective deferrals under § 403(b)(1)(E);
- (9) A failure involving contributions or allocations of Excess Amounts; or
- (10) Any other failure to satisfy applicable requirements under § 403(b) that (a) results in the loss of § 403(b) status for the plan or the loss of § 403(b) status for the

custodial account(s) or annuity contract(s) under the plan and (b) is not a Demographic Failure, an Eligibility Failure, or a failure related to the purchase of annuity contracts, or contributions to custodial accounts, on behalf of individuals who are not employees of the employer.

.06 Plan of an Ineligible Employer. The term "Plan of an Ineligible Employer" means a plan intended to satisfy the requirements of § 403(b) but which is not eligible for favorable tax treatment under § 403(b) because the employer is not a tax-exempt organization described in § 501(c)(3) or a public educational organization described in § 170(b)(1)(A)(ii).

.07 Total Sanction Amount. The term "Total Sanction Amount" means a monetary amount that is approximately equal to the income tax the Service could collect as a result of the failure.

SECTION 4. CORRECTION METHODS

.01 In general. The correction principles and rules of general applicability described in Section 6 of Rev. Proc. 98-22 apply to 403(b) Plans, except as provided in sections 4.02 and 4.03 below. Thus, a failure with respect to a 403(b) Plan is generally not corrected unless correction is made with respect to all participants and beneficiaries for all taxable years pursuant to this revenue procedure.

.02 Correction of Excess Amounts. Excess Amounts may be corrected only pursuant to paragraph (1) or (2) of this section 4.02.

(1) Distribution of Excess Amounts. In order to correct under this paragraph (1), Excess Amounts for a year, adjusted for earnings through the date of distribution, must

be distributed to affected participants and beneficiaries and are includible in their gross income in the year distributed. A distribution of Excess Amounts is generally treated in the manner described in Section 3 of Rev. Proc. 92-93, 1992-2 C.B. 505, relating to the corrective disbursement of elective deferrals. The distribution must be reported on Forms 1099-R for the year of distribution with respect to each participant or beneficiary receiving such a distribution. The distribution of Excess Amounts is not an eligible rollover distribution within the meaning of § 403(b)(8). In addition, the employer must inform affected participants and beneficiaries that the distribution of Excess Amounts is not eligible for rollover. Excess Amounts distributed pursuant to this paragraph (1) are not treated as amounts previously excludable under § 403(b)(2)(A)(ii) for purposes of calculating the maximum exclusion allowance for the taxable year of the distribution and for subsequent taxable years.

(2) Retention of Excess Amounts. Alternatively, only under TVC and Audit CAP for 403(b) Plans, Excess Amounts will be treated as corrected (even though the Excess Amounts are retained in the 403(b) Plan) if the requirements of this paragraph (2) are satisfied. Excess Amounts arising from a § 415 failure, adjusted for earnings through the date of correction, must reduce affected participants' applicable § 415 limit for the year following the year of correction (or for the year of correction if the employer so chooses), and subsequent years, until the excess is eliminated. Excess Amounts (whether arising from a § 415 failure or a § 403(b)(2) failure), adjusted for earnings through the date of correction, must also reduce participants' exclusion allowances by being treated as amounts previously excludable under § 403(b)(2)(A)(ii) beginning with

the year following the year of correction (or the year of correction if the employer so chooses). The correction described in this paragraph (2) must generally be used for all participants who have Excess Amounts. See section 8.03 below for the correction compliance fee that is generally applicable to Excess Amounts corrected pursuant to this paragraph (2).

.03 Correction of a Plan of an Ineligible Employer. The permitted correction of a Plan of an Ineligible Employer under TVC is the cessation of all contributions (including salary reduction and after-tax contributions) beginning no later than the date the application under TVC is filed. Pursuant to TVC correction, the assets in such a plan are to remain in the annuity contract or custodial account and are to be distributed no earlier than the occurrence of one of the distribution events described in § 403(b)(7) (to the extent the assets are held in custodial accounts) or § 403(b)(11) (for those assets invested in annuity contracts that would be subject to § 403(b)(11) restrictions if the employer were eligible). A Plan of an Ineligible Employer that is corrected through TVC will be treated as subject to all of the requirements and provisions of § 403(b), including the provisions of § 403(b)(8) (relating to rollovers). Because a Plan of an Ineligible Employer will be treated as subject to all of the requirements of § 403(b), the plan must, as part of TVC correction, also correct all other Operational, Demographic, and Eligibility Failures in accordance with this revenue procedure. The correction of a Plan of an Ineligible Employer is subject to the fee described in section 8.04 below (or, with respect to the correction of multiple failures, section 8.05 below).

SECTION 5. SELF-CORRECTION (APRSC)

.01 In general. Except as provided in section 5.02 below, the provisions of Sections 7, 8, and 9 of Rev. Proc. 98-22 generally apply for purposes of self-correcting a 403(b) Plan.

.02 Special rules for APRSC.

(1) APRSC is available to correct Operational Failures, but is not available to correct Demographic Failures or Eligibility Failures.

(2) A plan document is neither necessary nor sufficient to demonstrate that the employer, plan administrator, or insurer has in place established practices and procedures reasonably designed to facilitate overall compliance.

(3) To be eligible for APRSC, there is no requirement that the employer obtain a private letter ruling from the Service covering its 403(b) Plan. Section 4.03 of Rev. Proc. 98-22 does not apply.

(4) APRSC is available to correct Excess Amounts using the method described in section 4.02(1) above, but not the method described in section 4.02(2) above.

(5) To be eligible for APRSC, an employer must have (either directly or, where appropriate, through the insurer or custodian of the annuity contracts or custodial accounts under the 403(b) Plan) compliance practices and procedures in accordance with Section 4.04 of Rev. Proc. 98-22.

(6) APRSC is not available to correct Operational Failures that are egregious, Operational Failures relating to a diversion or misuse of plan assets, or other Operational Failures that are not eligible for correction under APRSC in accordance with Rev. Proc. 98-22.

SECTION 6. TVC PROGRAM

.01 In general. TVC generally allows employers to submit an application requesting correction of one or more Operational Failures, Demographic Failures, or Eligibility Failures. Under TVC, the employer pays a compliance correction fee, as described in section 8 below, and corrects the failures identified in accordance with the terms of a closing agreement entered into by the Service and the employer. Payment of the compliance correction fee is generally required at the time the closing agreement is signed. Depending on the nature of the failure and the plan's existing administrative procedures, the closing agreement may be conditioned on the implementation of stated administrative procedures.

.02 TVC requirements. The provisions of Rev. Proc. 98-22 relating to Walk-in CAP generally apply to TVC except that TVC applies to Operational Failures, Demographic Failures, and Eligibility Failures in a 403(b) Plan. In addition, there is no requirement that the employer obtain a private letter ruling from the Service covering its 403(b) Plan. Section 4.03 of Rev. Proc. 98-22 does not apply.

.03 Eligibility for TVC. TVC is not available if the 403(b) Plan or the employer is Under Examination.

.04 Failures covered by TVC. TVC is expanded to cover all Operational Failures, Demographic Failures, and Eligibility Failures that are within the jurisdiction of the EP/EO Division of the Key District Office, including Plans of Ineligible Employers. TVC is available to correct egregious failures; however, these failures are subject to the fee described in section 8.06 below. TVC is not available with respect to failures

relating to the diversion or misuse of plan assets.

.05 Correction of Excess Amounts. Failures related to Excess Amounts may be corrected under TVC in the manner described in paragraph (1) or (2) of section 4.02 above, and are subject to the fee described in section 8.02 or 8.03, respectively.

SECTION 7. APPLICATION PROCEDURES FOR TVC

.01 In general. The procedures and submission requirements of Section 12 of Rev. Proc. 98-22 apply for purposes of TVC.

.02 Submission requirements. In addition to the submission requirements provided in Section 12.03 of Rev. Proc. 98-22, an application under TVC must contain a statement that the employer has contacted all other entities involved with the plan and has been assured of cooperation in implementing the applicable correction, to the extent necessary. For example, if the plan's failure is the failure to satisfy the requirements of § 403(b)(1)(E) on elective deferrals, the employer must, prior to making the TVC application, contact the insurance company or custodian with control over the plan's assets to assure cooperation in effecting a distribution of the excess deferrals and the earnings thereon.

.03 Required documents. A TVC submission must be accompanied by the following documents:

(1) If applicable, the first two pages of the most recently filed Form 5500, or if inapplicable, the information generally included on the first two pages, including the name and number of the plan, and the employer's Employer Identification Number.

(2) A statement as to the type of employer (e.g., a tax- exempt organization

described in § 501(c)(3)) submitting the TVC application.

(3) A copy of the pertinent portions of any relevant § 403(b) documents such as plan documents, written descriptions of the plan, and sample salary reduction agreements.

(4) The letter to the Service requesting consideration under TVC must be designated "TVC PROGRAM."

(5) TVC submissions must be mailed to the Closing Agreement Coordinator in the appropriate Key District Office as provided in Section 12.12 of Rev. Proc. 98-22.

.04 Checklist. A checklist in Appendix B of Rev. Proc. 98-22 is provided for use by an employer in preparing a TVC request.

SECTION 8. FEES FOR TVC

.01 TVC compliance correction fee. The applicable TVC compliance correction fee depends on the type of failure and, generally, the number of employees of the employer.

.02 Fee for Operational Failures. Subject to section 8.05 below, the compliance correction fees for Operational Failures are as follows:

- (1) The fee for an employer with fewer than 25 employees is \$500.
- (2) The fee for an employer with at least 25 and no more than 1,000 employees is \$1,250.
- (3) The fee for an employer with more than 1,000 employees but less than 10,000 is \$5,000.
- (4) The fee for an employer with 10,000 or more employees is \$10,000.

.03 Fee for certain Excess Amounts. Subject to section 8.05 below, the compliance correction fee for Excess Amounts that are corrected pursuant to section 4.02(2) above is equal to the sum of (1) the applicable fee described in section 8.02 above and (2) two percent of the Excess Amounts, adjusted for earnings through the date of the TVC application, contributed or allocated in the calendar year of the TVC application and in the three calendar years prior thereto. For purposes of determining the fee described in this section 8.03, where there is a failure to satisfy both the § 403(b)(2) and § 415 limits with respect to a single employee for a year, the fee will take into account only the greater Excess Amount.

.04 Fee for Demographic and Eligibility Failures. (1) Subject to section 8.05 below, the compliance correction fee for a 403(b) Plan with failures that include Demographic or Eligibility Failures is determined in accordance with the table set forth below. It is expected that in most instances the compliance correction fee imposed will be at or near the presumptive amount in each range; however, the fee may be a higher or lower amount within the range, depending on the factors in paragraph (2) below. This table is the same as the table provided in Section 13.05 of Rev. Proc. 98-22, except that (a) the reference to the "VCR fee" is changed to refer to the TVC compliance correction fee for Operational Failures set forth in section 8.02 above, and (b) the fee is determined with reference to the number of employees rather than participants.

FEES FOR DEMOGRAPHIC AND ELIGIBILITY FAILURES

# of employees	Fee range	Presumptive Amount
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10 or fewer	TVC fee for Operational Failures to \$4,000	\$2,000
11 to 50	TVC fee for Operational Failures to \$8,000	\$4,000
51 to 100	TVC fee for Operational Failures to \$12,000	\$6,000
101 to 300	TVC fee for Operational Failures to \$16,000	\$8,000
301 to 1,000	TVC fee for Operational Failures to \$30,000	\$15,000
Over 1,000	TVC fee for Operational Failures to \$70,000	\$35,000

(2) Consideration of whether the compliance correction fee for a 403(b) Plan with failures that include Demographic or Eligibility Failures should be equal to, greater than, or less than the presumptive amount set forth in section 8.04(1) above will depend on factors relating to the nature, extent, and severity of the failure. These factors include: (a) whether the failure is a failure to satisfy the requirements of § 401(a)(4), § 401(a)(26), or § 410(b) (pursuant to § 403(b)(12)(A)(i)); (b) whether the plan is a Plan of an Ineligible Employer; (c) whether the 403(b) Plan has a combination of Operational, Demographic, and Eligibility failures; and (d) the period of time over which the failure occurred.

.05 Fee for multiple failures. If correction is requested for multiple failures, the compliance correction fee will be

determined in accordance with the table set forth below.

Multiple Operational Failures	Fee described in section 8.02
Multiple Demographic/Eligibility Failures	Fee described in section 8.04
Combination of Operational and Demographic/Eligibility Failures	Fee described in section 8.04
Operational Failure(s) with section 4.02(2) correction of Excess Amounts	Fee described in section 8.03
Demographic/Eligibility Failures and Operational Failures including section 4.02(2) correction of Excess Amounts	Fee described in section 8.03, substituting section 8.04 fee for section 8.02 fee

.06 Fee for egregious failures. Consistent with section 13.05(3) of Rev. Proc. 98-22, in cases involving failures that are egregious, the maximum compliance correction fee applicable to the plan is increased to 40 percent of the Total Sanction Amount and no presumptive amount applies.

SECTION 9. AUDIT CAP FOR 403(B) PLANS

.01 Audit CAP requirements. The provisions of Sections 14 and 15 of Rev. Proc. 98-22 are expanded to cover 403(b) Plans. Thus, in the event the Service identifies an Operational Failure, Demographic Failure, or an Eligibility Failure upon an Employee Plans or Exempt Organizations examination (other than a failure that has been corrected under APRSC or TVC or that is eligible for correction under APRSC), the requirements of Section 14 of Rev. Proc. 98-22 are satisfied with respect to the failure if the

employer corrects the failure, pays a sanction in accordance with section 9.02 below, adopts appropriate administrative procedures, and enters into a closing agreement with the Service. Audit CAP for 403(b) Plans is not available for failures relating to a misuse or diversion of plan assets.

.02 Payment of sanction. The sanction under Audit CAP for 403(b) Plans is a negotiated percentage of the Total Sanction Amount. Sanctions will not be excessive and will bear a reasonable relationship to the nature, extent, and severity of the failures. The amount of the sanction will depend on factors relating to the nature, extent, and severity of the failures, including the extent to which correction had progressed before the examination was initiated. Other factors relating to the nature, extent, and severity of the failures include: (1) the number and type of employees affected by the failure; (2) the number of nonhighly compensated employees who would be adversely affected if the plan were not treated as a plan described in § 403(b); (3) whether the failure is a failure to satisfy the requirements of § 401(a)(4), § 401(a)(26), or § 410(b) (pursuant to § 403(b)(12)(A)(i)); (4) the extent to which the failure relates to Excess Amounts; (5) whether the plan is a Plan of an Ineligible Employer; (6) whether the plan has a combination of Operational, Demographic, or Eligibility Failures; (7) the period over which the failure occurred; and (8) the reason for the failure (for example, data errors such as errors in transcription

of data, the transposition of numbers, or minor arithmetic errors).

SECTION 10. EFFECT ON OTHER DOCUMENTS

.01 Except as provided in section 11 below, the TVC program described in Rev. Procs. 95-24 and 96-50 is modified and superseded by this revenue procedure.

.02 Rev. Proc. 99-8, 1999-1 I.R.B. 229, is modified as provided in section 10 of this revenue procedure.

.03 Rev. Proc. 98-22 is modified and amplified by this revenue procedure.

SECTION 11. EFFECTIVE DATE

The effective date of this revenue procedure is January 1, 1999. However, a TVC application made on or after January 1, 1999 and prior to July 1, 1999 will be reviewed under the guidance provided in Rev. Procs. 95-24 and 96-50, unless the applicant indicates that the TVC application should be reviewed under the guidance provided in this revenue procedure. TVC applications made on and after July 1, 1999 will in all cases be reviewed in accordance with the guidance provided in this revenue procedure.

SECTION 12. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1645.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the

collection of information displays a valid control number.

The collection of information in this revenue procedure is in sections 1.01, 4.02, 4.03, 6.01, 6.02, 6.04, 6.05, 7.01-7.04, and 9.01 of this revenue procedure. This information is required to enable the Office of Assistant Commissioner (Employee Plans and Exempt Organizations) of the Internal Revenue Service to make determinations regarding the issuance of various types of closing agreements. This information will be used to issue closing agreements to allow individual plans to continue to maintain their tax qualified status. As a result, favorable tax treatment of the benefits of the eligible employees is retained. The likely respondents are state or local governments and nonprofit institutions.

The estimated total annual reporting and/or recordkeeping burden is 1,899 hours.

The estimated annual burden per respondent/recordkeeper varies from .5 to 12 hours, depending on individual circumstances, with an estimated average of 3.8 hours. The estimated number of respondents and/or recordkeepers is 500.

The estimated frequency of responses is occasionally.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

DRAFTING INFORMATION

The principal author of this revenue procedure is Rosamond S. Ferber of the Employee Plans Division. For more information concerning this revenue procedure, call the Employee Plans Division Telephone Number, (202) 622-6074 or (202) 622-6075 (not a toll-free number) between the hours of 1:30 and 4:00 pm, Monday through Thursday. Ms. Ferber may be reached at (202) 622-6214 (also not a toll-free number).