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IRS Announces Pre-Audit Compliance Pilot Program

by R. Sterling Perkinson

On June 3, 2022, the IRS announced a new pre-audit compliance program for retirement plans beginning immediately in June 2022 (the "Pilot Program"). Under the Pilot Program, the IRS will send a pre-audit letter to plan sponsors whose retirement plans have been selected for upcoming audits ("Pre-Audit Letter") and the plan sponsor will have 90 days to identify and correct any compliance issues with their plans and to notify the IRS of the corrective actions taken.

Plan sponsors have a couple of strong incentives to take action to identify and correct any compliance failures upon receiving a Pre-Audit Letter:

Avoiding or Limiting Audits. The IRS's announcement indicates that if a plan sponsor does not respond to the Pre-Audit letter within 90 days, it will move forward with scheduling an audit. But if a plan sponsor responds to the Pre-Audit Letter, the IRS will assess whether to issue a closing letter or to conduct a limited or full scope audit. The IRS has not provided guidelines as to how it will make this assessment, but it appears that plan sponsors will have some ability to avoid or limit a potential audit by responding to the Pre-Audit Letter in a way that demonstrates a commitment to voluntary compliance.

Reduced Sanctions. The IRS has indicated that it will assess sanctions for any compliance failures corrected under the Pilot Program (other than failures eligible for self-correction) based on the user fees for its Voluntary Correction Program (VCP), which currently has a maximum user fee of $3,500. VCP is not available to plan sponsors once they have received verbal or written notification of a pending audit. Ordinarily, compliance issues discovered under audit (other than "insignificant" operational failures) are subject to sanctions under the IRS's Audit Cap Program, which depend on the IRS's assessment of the nature, extent, and severity of the failure, but in any case tend to be significantly higher than VCP user fees.

As a result, plan sponsors that receive a Pre-Audit Letter should begin the process of assessing any compliance failures, taking any appropriate corrective actions, and preparing a summary of any compliance issues for the IRS.

The announcement indicates that the IRS will reevaluate the effectiveness of the Pilot Program at the end of the pilot period and determine whether it should be made permanent. However, the announcement does not specify when the pilot period ends.