



# Current Trends in DOL & IRS Investigations

**Peter Jones**  
Counsel  
Tucker Ellis

**Allison Wilkerson**  
Partner  
McDermott Will & Emery

**Presented by The ESOP Association**

# WELCOME

- For the Virtual Audience
  - Your computer & phone mics are muted.
  - To ask & monitor questions, click the Q&A icon in the toolbar.
- The Session presentation is in **The Hub** located on TEA's website.
- Sessions are being recorded and will be available through the portal until August 2021.
- Time is limited and the Speakers will do their best to answer as many questions as possible. Not enough time for your question – pose it to **The Hub**.





# THE ESOP ASSOCIATION DISCLAIMER

TEA presentations are solely for educational purposes and provide only general descriptions of various issues, including legal and regulatory, that impact the ESOP community. While designed to be accurate and authoritative, TEA educational sessions do not provide legal, regulatory, fiduciary, valuation, accounting, administrative or similar professional services and/or advice. Attendees should consult the relevant regulation, case law, or professional standards and should consult their own paid professional advisors for guidance relevant to their specific situation. Nothing presented in a TEA session constitutes legal advice and attendees should retain the services of an appropriate professional for such advice. TEA and its presenters make no warranty, express or implied, with respect to such information and disclaim all liability resulting from any use or reliance of this information.





# **THE ESOP ASSOCIATION DISCLAIMER**

**TEA presentations are the sole property of The ESOP Association. Photocopying, distributing or using these materials electronically without the owner's express written consent is strictly prohibited. Consent is granted for the use of purchasers of TEA events and then solely for the use of registered session attendees. No right or license is given to reproduce the materials in any form or format or to place the materials in any formation to any website or blog or to otherwise republish it in any manner without express written permission of TEA – The ESOP Association.**





# EDUCATIONAL PARTNER

The logo for the Employee Ownership Foundation. It features the words "EMPLOYEE OWNERSHIP" in a large, bold, dark blue sans-serif font, stacked on two lines. Below this, the word "FOUNDATION" is written in a smaller, bold, red sans-serif font. The background of the logo is a light gray, semi-transparent image of a classical building with columns.

**EMPLOYEE  
OWNERSHIP**  
**FOUNDATION**

**Visit [EmployeeOwnershipFoundation.org](https://EmployeeOwnershipFoundation.org) to Donate.**

# STRATEGIC PARTNER



TI  TRUST  
TRUE INTEGRITY FIDUCIARY SERVICES

# PLATINUM SPONSORS



**Fred C. Church**  
I N S U R A N C E

**PRO✓ACT**  
PHARMACY BENEFIT MANAGEMENT

# GOLD SPONSORS



# SILVER SPONSORS



- **BKD CPAs & Advisors**
  - **Cornerstone Government Affairs, Inc.**
    - **eatNgage**
      - **GreatBanc Trust Company**
        - **McDermott, Will & Emery LLP**

# BRONZE SPONSORS



- **Boulay**
- **Columbia Financial Advisors, Inc.**
- **Crowe LLP**
- **ESI Equity**
- **ESOP Plus®: Schatz Brown Glassman LLP**
- **The Menke Group**
- **Praxis Consulting Group, Inc.**
- **Southard Financial, LLC**
- **Wright Service Corp**

# SUPPORTERS



- Aqua Engineers, Inc.
- Cisco-Eagle
- ESOP Law Group, LLP
- Fiduciary Services, Inc.
- Gemini Industries
- STOUT



**Pete Jones**

Attorney - Partner

Tucker Ellis

614-358-9308

Peter.Jones@tuckerellis.com

# TODAY'S SPEAKER

With Tucker Ellis LLP, Peter Jones advises business owners, companies, and fiduciaries on employee stock ownership plans, transition strategies, corporate governance, employee benefits, executive compensation, and mergers and acquisitions. Pete's experience includes representing companies and trustees in the formation of ESOPs, the sale of ESOP-owned companies, and acquisitions undertaken by ESOP-owned companies. He also advises clients on regulatory compliance and defends them in connection with audits and investigations by the Department of Labor and the Internal Revenue Service. Active with the ESOP Association at both the national and regional level, Pete is a frequent speaker on issues related to ESOPs.

#TEANATIONAL2021





**Allison Wilkerson**

**Attorney - Partner**

**McDermott Will &  
Emery**

**214.295.8010**

**[awilkerson@mwe.com](mailto:awilkerson@mwe.com)**

# TODAY'S SPEAKER

Allison Wilkerson focuses her practice on employee benefits matters. She has extensive experience handling issues pertaining to the Employee Retirement Income Security Act of 1974 (ERISA) and employee stock ownership plans (ESOPs).

Allison focuses her ESOP practice on the design and implementation of ESOP transactions and provides ongoing legal counsel to ESOP-owned companies. She has been involved in hundreds of transactions, including leveraged buyouts, mergers, acquisitions, and the structuring and financing of ESOPs using private equity. She has advised employers on the implementation of nonqualified plans and executive compensation arrangements that complement the employee ownership structure and culture inherent in an ESOP-owned company. Allison also represents independent fiduciaries in their role as purchaser in an ESOP transaction as to their legal duties with respect to their representation of ESOP participants and beneficiaries.

Allison writes and speaks frequently on ERISA and ESOP issues.

**#TEANATIONAL2021**



# Learning Objectives

**At the end of the session, you will be able to:**

1. Explain the broad scope of authority under which the Federal government reviews ESOPs and the discretion given to each region to enforce ESOP compliance.
2. Understand common allegations raised against ESOPs.
3. Demonstrate how to prepare an effective record in advance of an investigation .



# AGENDA



## Covered in Today's Session:

- IRS Audits
- DOL Audits
- So You've Received an Audit Notice...
- Best Practices



**TEA NATIONAL  
CONFERENCE 2021**  
WASHINGTON, D.C. • JUNE 21-23

# IRS AUDITS

#TEANATIONAL2021



# IRS AUDITS

An IRS Audit may occur as a result of:

- Random selection
- Referral from the DOL
  - Certain matters found on audit by the DOL are required to be reported to the IRS
- Compliance Program Initiatives  
(<https://www.irs.gov/government-entities/tax-exempt-government-entities-compliance-program-and-priorities>)
- Participant complaints



# IRS AUDITS

- IRS audits of ESOPs seem to have increased since 2017
- Form 5500 review/focus
- 2020 compliance programs\* include an ESOP focus
  - “determine whether the employee stock has been properly valued, the annual allocation of employee stock meets the nondiscrimination requirements and the employer loans follow the conditions and terms of the plan document”

\*<https://www.irs.gov/pub/irs-tege/tege-fy2020-program-letter.pdf>



# IRS Audits

## Scope of a Typical Exam

### Documentary and Operational Compliance Issues

- Documentary compliance
  - Proper and timely signed plan documents and amendments
  - Favorable Determination Letter
  - Returns and Reports
- Operational compliance
  - Eligibility, Participation, Coverage
  - Vesting
  - Discrimination
  - Contribution and Benefit Limits
  - Distributions

#TEANATIONAL2021



**TEA NATIONAL  
CONFERENCE 2021**  
WASHINGTON, D.C. • JUNE 21-23

# IRS Audits

## Scope of a Typical Exam

### ESOP Matters Compliance

- Form 5500 investigation – Information Document Request(s) (IDRs) served on the *plan administrator*
- ESOP Loan Compliance
- Valuation review and requirements
  - Solicitation of “transaction valuations”
  - Request for work papers
  - Request for correspondence
- “Procedural” and “systems” information

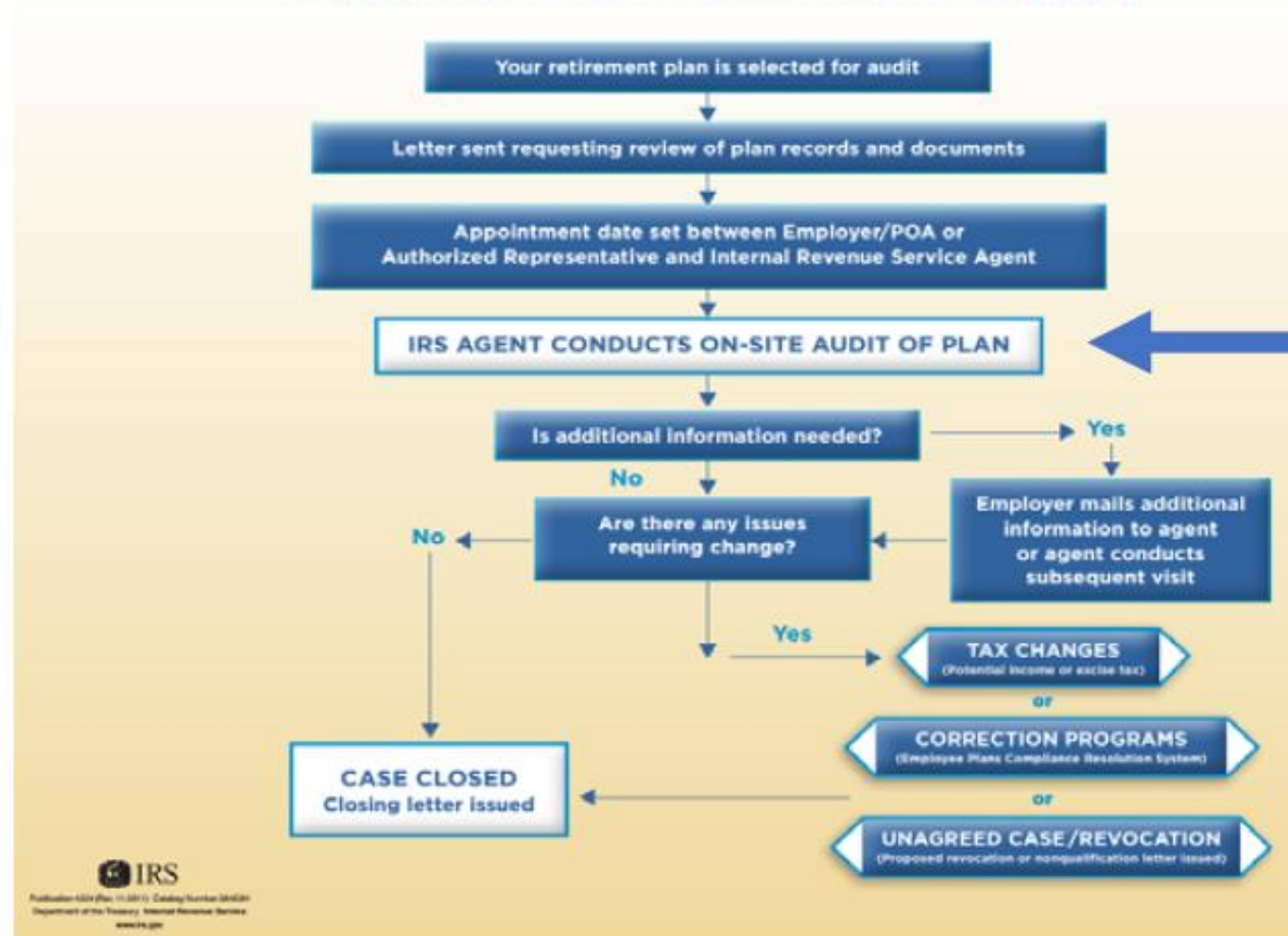


**TEA NATIONAL  
CONFERENCE 2021**  
WASHINGTON, D.C. • JUNE 21-23

# IRS Audits



## Employee Plan Examination Process



Generally includes interview  
With appropriate person(s)  
with information about the plan



Publication 4034 (Rev. 11-2017) Catalog Number 340401  
Department of the Treasury Internal Revenue Service  
www.irs.gov



**TEA NATIONAL  
CONFERENCE 2021**

WASHINGTON, D.C. • JUNE 21-23

#TEANATIONAL2021

# IRS Audits

## Findings

- Clean letter without further need for action
- Identification and discussion self corrected matters (acknowledgement of correction without further liability/action)
- Recommendations for consideration in future actions
- Findings of compliance issues
- Prohibited transaction events



**TEA NATIONAL  
CONFERENCE 2021**  
WASHINGTON, D.C. ★ JUNE 21-23

#TEANATIONAL2021

# IRS Audits

## Helpful IRS Publications

- IRS Revenue Manual – EP Examination Guidelines (broken down by technical topics) [<http://www.irs.gov/Retirement-Plans/EP-Examination-Guidelines>]
- Form 5772 – Audit Plan (procedural and technical requirements reviewed by agents) [<http://www.irs.gov/pub/irs-tege/form5772.pdf>]
- Employee Plan Examination Process Brochure (identification of other helpful publications and common areas of review) [[http://www.irs.gov/pub/irs-tege/exam\\_overview.pdf](http://www.irs.gov/pub/irs-tege/exam_overview.pdf)]
- 401(k) Plan Checklist (identifies requirements for a 401(k) qualified plan) [<http://www.irs.gov/pub/irs-tege/pub4531.pdf>]



**TEA NATIONAL  
CONFERENCE 2021**  
WASHINGTON, D.C. • JUNE 21-23

# DOL AUDITS

#TEANATIONAL2021



# DOL AUDITS

An DOL Audit may occur as a result of:

- Random selection
  - A certain number of plans filing a Form 5500 are selected each year for audit
- Concerns over information included in the Form 5500
  - Identification of late contributions
  - Lack of Fidelity Bond
  - Improper completion of Schedule C identifying compensation paid to providers
- Participant complaints
  - Office of Participant Education – a DOL office allowing for complaints of possible ERISA violations
- **National Enforcement Project**



# DOL Audits

## ESOP Audit Activity

- In 2012, DOL started a campaign to address perceived abuses in ESOP transactions
- Two pronged attack, including initiation of targeted litigation to address perceived overvaluations of stock purchased by ESOPs
- Development of the National Enforcement Project for ESOPs – see <https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/enforcement> (National Enforcement Projects - ESOPs)
- Service provider audits



**TEA NATIONAL  
CONFERENCE 2021**  
WASHINGTON, D.C. • JUNE 21-23

#TEANATIONAL2021

# DOL AUDITS

## DOL Investigative Authority

- The DOL has been very active in ESOP investigations
  - The DOL has **broad** subpoena and investigatory powers
  - Standing is not an issue as ERISA grants Secretary of Labor standing to sue
- DOL investigations can lead to criminal indictments in addition to civil penalties
  - Willful violation of ERISA reporting and disclosure requirements – up to \$5,000 in fines per individual, \$100,000 for any other entity, and possible 1 year imprisonment
  - Knowingly making false statements or concealing or failing to disclose any fact needed to prepare ERISA reports - \$10,000 fine, 5 years imprisonment, or both
- Statute of Limitations
  - May be suspended under Tolling Agreement



# DOL Audits

## Common Issues Raised by the DOL



- ESOP Valuations...ESOP Valuations...ESOP Valuations
  - Transaction and annual administrative valuations are reviewed closely
  - ESOP valuations have been “an area of chronic problems” and that the DOL is pursuing a “big number” of cases for 2014. ~ Tim Hauser of EBSA at the ABA Conference, February 2014
  - “Valuation is the first, second, third, and fourth problem” of ESOP deals. ~ Tim Hauser of EBSA in the WSJ
  - Focus of DOL in ESOP Transactions

Was the transaction designed primarily to benefit the employees (and their retirement)?

~ OR ~

Was it merely a capital financing tool to enrich the sellers?



**TEA NATIONAL  
CONFERENCE 2021**  
WASHINGTON, D.C. • JUNE 21-23

#TEANATIONAL2021

# DOL Audits

## Valuation Challenges

- Improper projections
- Improper company specific risk premium
- Improper valuation methodology
- Improper guideline companies
- Incorrect process undertaken by the fiduciary
- Failure to meet the duty to monitor
- Conflicts of interest
- Ongoing engagement issues for transactional engagement
- Paid for control/added a control premium



**TEA NATIONAL  
CONFERENCE 2021**  
WASHINGTON, D.C. • JUNE 21-23

# DOL Audits

## Common Issues Raised by the DOL

- Exempt Loan Document Issues
  - Forgiveness of debt as a repayment technique
  - Payment of attorneys fees and costs on an event of default
  - Interest calculations (through payment date on the loan)
  - Use of pre-transaction contributions to pay debt
- Indemnification Agreements between company and fiduciary
- Fidelity bond
- Conflict of Interest Issues
  - Internal trustee during ESOP transaction is conflicted (e.g. also on the board of directors)
- Redemptions from non-ESOP shareholders while the ESOP is in place
- Payment of plan expenses



**TEA NATIONAL  
CONFERENCE 2021**  
WASHINGTON, D.C. • JUNE 21-23

# RECEIPT OF AN AUDIT NOTICE

#TEANATIONAL2021



# Audit Response

## So You Have Received an Audit Notice....

- Determine the applicable investigation period
  - Investigation is generally a 3-year look back period
  - Can go back as far as 6-years
  - May include pre-audit period documents
    - E.g., exempt loan is still in place
- Establish the location of the audit
  - Off-site location
- Identify documents to be provided to the agent
  - Counsel review/assistance
  - Only provide what is asked for in the request
- Identify plan sponsor representative
- Notify providers
  - E.g., trustee, third party administrator, auditor, etc.

#TEANATIONAL2021



**TEA NATIONAL  
CONFERENCE 2021**  
WASHINGTON, D.C. ★ JUNE 21-23

# Audit Response



## Organization is the Key – Top Factors in Successful Completion of an Audit

- Organize a response team (ERISA counsel, HR, etc.)
- Appoint 1 person for all contact with the investigator – generally ERISA Counsel
- Have ERISA Counsel serve as conduit for all information and communication
- Generally will need to seek additional time to respond; confirm in writing
- Provide only the documents requested but be comprehensive – Keep copies and keep in order produced so you can easily access when questions
- Use FOIA exemption where viable
- Notify senior management and liability insurer
- Work with ERISA counsel to prep for interviews
- Debrief employees after they meet with DOL investigator
- **Keep notes of all interviews and all responses**



# Audit Response



- Have ERISA Counsel sit in on interviews
  - Includes counsel for providers (Trustee/Financial Advisor)
- Be cooperative and helpful
- Answer the question asked...and only the question asked
- Do not be afraid to respond with "I don't know" or "I will have to review my files"
- Do not speculate on anything that is outside your responsibility, expertise or knowledge
- Do not state anything you know to be untrue



**TEA NATIONAL  
CONFERENCE 2021**  
WASHINGTON, D.C. • JUNE 21-23

# Audit Response

## No Matter How Hard You Try.....

- Even when following letter of the law, issues may arise during audit resulting from:
  - Ambiguity
  - Conflicting regulations between different regulatory agencies
- May receive DOL communication stating you have breached your fiduciary duties:
  - Review requirements with counsel
  - Prepare response letter
  - (If appropriate) Propose corrective action
  - (If appropriate) Request reduction in penalties



**TEA NATIONAL  
CONFERENCE 2021**  
WASHINGTON, D.C. ★ JUNE 21-23

# BEST PRACTICES

#TEANATIONAL2021



# Internal Plan Audits



- Monitor and confirm on-going compliance
- Use available correction programs
  - IRS Correction Program
    - “EPCRS” – Employee Plans Compliance Resolution System
    - Types of Failures: Plan Document Failure, Demographic Failure, Operational Failure
    - NOT Available if the Plan is Under Audit
  - DOL Correction Program
    - Voluntary Fiduciary Correction Program
    - Self-correction of ERISA compliance issues
    - Focus is on fiduciary violations
- Self regulation and correction evidences good internal controls



# Know Your Responsibilities



## Board of Directors/ESOP Committee

- Appoint and monitor ESOP Trustee
- Direct trustee per plan document
- Plan administration responsibility
  - Determine ESOP contributions
  - Oversee ESOP distribution process
  - Adopt, amend and/or terminate ESOP
  - Evaluate repurchase liability
- Declare dividends/distributions to be paid to shareholders



# Know Your Responsibilities

## Trustee

- Maintain custody of plan assets'
  - Updated stock certificates for released shares
- Manage liquid assets
  - Investment requirements?
  - Is the trustee directed?
- Receive contributions and dividends/distributions
- Make ESOP loan payments
- Determine fair market value of shares held by ESOP
- Vote ESOP shares
- Elect and Monitor board of directors
  - Must properly elect the board of directors



# Know Your Responsibilities

## Valuation Issues

- The Board of Directors and the Trustee must know the valuation requirements
  - "Fair Market Value"
  - The Trustee is the responsible party for setting value
  - Proper Process:
    - Proper selection of the Appraiser
    - Proper Engagement Process
    - Proper information provide to the Appraiser
- Review the report
  - Ask questions
  - Review the valuation approach(es)
  - Review and question methodology used to determine value
  - Document the review process



# Prepare for the Audit Interview

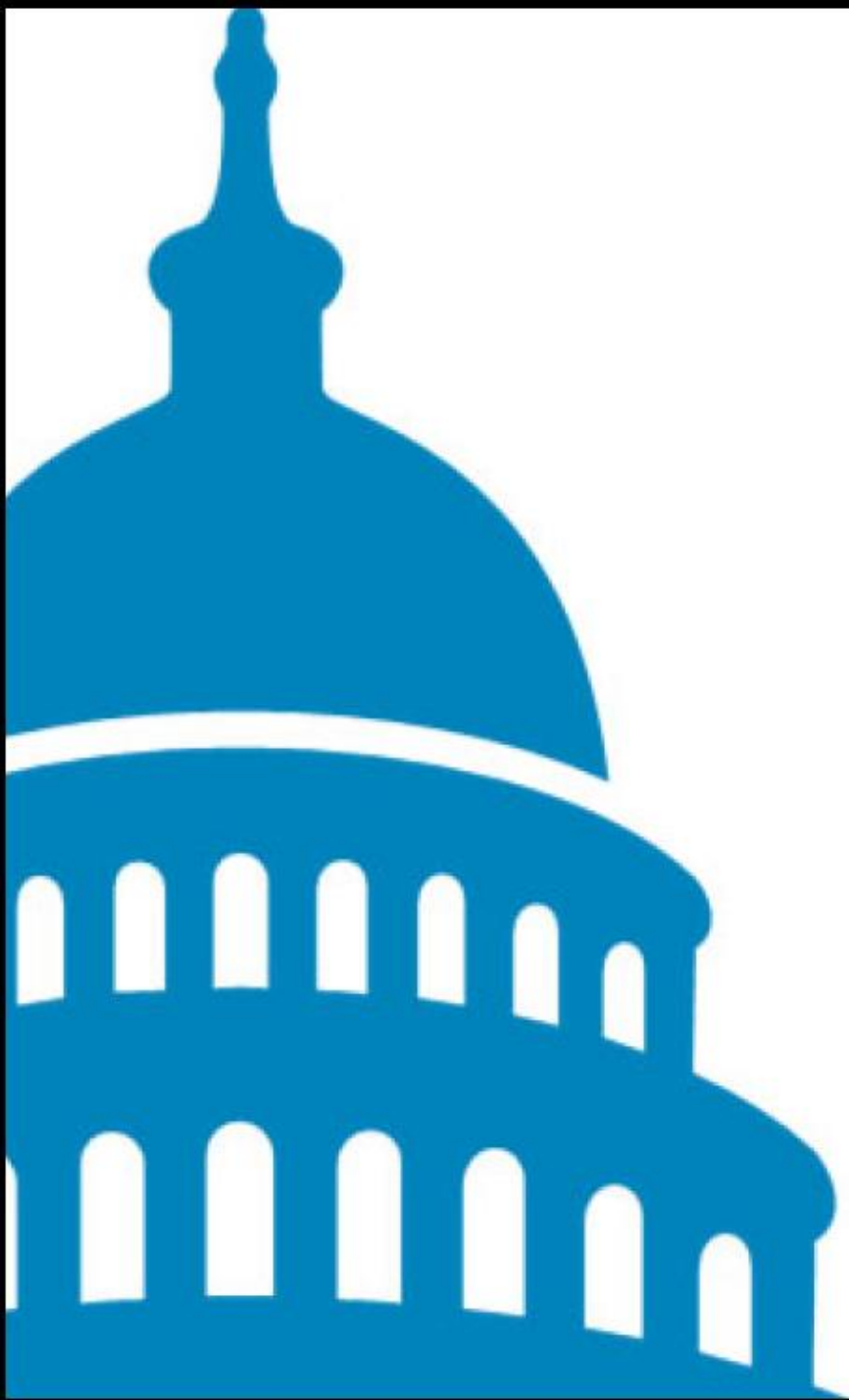
- Understand the pre-transaction process
  - How was the trustee selected?
  - (If you are a trustee) How was the valuation firm selected?
  - What drove the decision to seek an ESOP ownership transition?
  - Did the company use an investment banker or other advisor?
- Understand the process under taken in connection with transaction negotiations
  - Fairness Opinion Support/ Valuation Report – the company will not receive but should keep track of information provided
  - Historical financial information, including unusual items/ addbacks
  - Operating data
  - Projections and risk factors/limits to growth
- Negotiation Process
  - Verbal?
  - Pursuant to an LOI?



# Prepare for the Audit Interview

- Understand the terms of the transaction
  - Seller Debt
  - Warrants?
  - Equity Compensation
- Ongoing Post-Transaction Operations
  - Board of Director Elections
  - Compensation
  - Who is the administrator?
  - The Administrative Process
    - Communication/timing
    - Distributions
    - Respond to participant requests for information





# QUESTIONS



#TEANATIONAL2021



**TEA NATIONAL  
CONFERENCE 2021**  
WASHINGTON, D.C. ★ JUNE 21-23

# It was great having you with us!

For the Virtual Audience, be sure to log into the next room to view some special messages.

Be sure to watch what happens in the breaks.

Don't forget to visit **THE HUB!**



# Thank You For Joining Us!

#ESOPOnline

\*\*\*\*\*

**Peter Jones**

Counsel

Tucker Ellis

Peter.jones@tuckerellis.com

**Allison Wilkerson**

Attorney – Partner

McDermott Will & Emery

awilkerson@mwe.com

**JOIN THE CONVERSATION ON THE HUB!**

**<https://network.esopassociation.org/home>**



**TEA NATIONAL  
CONFERENCE 2021**

WASHINGTON, D.C. ★ JUNE 21-23