Scrivener's Error— An Overdue Doctrine for Qualified Plan Corrections

As every voter in Palm Beach County now knows: You can't correct your mistaken vote after you've walked out of the polling booth—no matter how dumb or obvious the error.

Should the same principle apply to a qualified plan document, once signed?

The IRS says yes—once it's in writing, it's in stone.

We here argue that the IRS should reexamine its position, both as a matter of law and policy.

Background

The IRS takes the position that failure to follow the written terms of a plan is a disqualifying error. An administrative practice that would be okay if reflected in the plan document, blows up the plan's tax-favored status if not. "Scrivener's error" is not a permitted defense. If differences between the plan document and administration arise, the plan sponsor can avoid disqualification only by retroactively conforming practice to writing. Retroactive correction of the written plan is not effective. (See, e.g., Rev. Proc. 98-22, 1998-12 I.R.B. 11, *modified, amplified,* Rev. Proc. 99-13, 1999-5 I.R.B. 52.)

The authority for the IRS's position that the written document always prevails is Treas. Reg. Section 1.401-1(a)(2), which pre-dates ERISA and requires that a qualified plan be a "definite written program" that is "communicated to employees." In affirming the regulation's validity post-ERISA, the Tax Court has cited the ERISA conference report, which states that a "written plan" is required in part so that "every employee may, on examining the plan documents, determine exactly what his rights and obligations are under the plan." (*Engineered Timber Sales, Inc., Petitioner v. Commissioner*, 74 T.C. 808 (1980) (citing Conf. Rept. 93-1280 (1974), 1974-3 C.B. 415, 418).)

So far, this policy has been read to bar amendment of clear draftsman's errors. To take a couple of hypothetical examples: consider

a plan sponsor that eliminates a matching contribution to a 401(k) plan (perhaps after acquiring it pursuant to a business acquisition). Let's say the sponsor mistakenly checks the wrong box on the joinder agreement—"50% match," rather than "no match," but correctly reforms the SPD and all other participant communications. Under the IRS's current position, this mistake can be corrected only by providing the match. Another example: The plan's loan program is (mistakenly) deleted in the plan draft, but not in the SPD, or administrative practice, or the plan's loan documents. A disqualifying error.

We will return to these examples when we conclude that under law and policy, these errors should be subject to correction by retroactive plan amendment.

Scrivener's Error Under ERISA

This discussion is complicated somewhat by the fact that there are two laws involved: Title I of ERISA which deals with participants' underlying contractual rights (and the sponsor's fiduciary obligations), and the Internal Revenue Code, which governs the plan's tax qualification under Section 401.

Under ERISA, federal courts have recognized a variety of "federal common law" doctrines that allow retroactive amendment of an erroneous plan provision. (For a brief survey of these, see Barker, "Is There a Scrivener's Error Doctrine in ERISA?," 13 *Benefits Law Journal* 59 (Spring 2000).)

Some argument may be made that, if an error might be reformed for ERISA Title I purposes, reformation should be permitted for tax purposes as well. Such reformation is permitted for Code sections outside Section 401. For purposes of determining the tax treatment of various corporate transactions, for example, the Tax Court has held that a written contractual agreement may be read as "corrected" for what the taxpayer contends is a scrivener's error in the document. (*State Pipe & Nipple Corp. v. Commissioner*, TC Memo 1983-339 (1983); *Sharewell Inc. v. Commissioner*, TC Memo 1999-413 (1999).) In these cases, the court stated that parol evidence of "mutual mistake" (classic scrivener's error) is admissible to correct documents for tax purposes. The scrivener's error doctrine of these cases applied even under the strict document-driven *Danielson* rule, which generally provides that the written form of an agreement governs its tax consequences. Moreover, the scrivener's error doctrine applied in these cases for determining tax treatment, even though the contracts in question had not actually been reformed by a state court, and the Tax Court does not, of course, have jurisdiction

otherwise to reform a contract between private parties. (See, e.g., *Woods v. Commissioner*, 92 T.C. 776 (1978).)

There are limits in the usefulness of the *State Pipe & Nipple* and *Sharewell* principle, however.

First, in each case the Tax Court provisionally bought the petitioners' arguments that the scrivener's error was such that the contract would be reformed or set aside under governing state law. In contrast with the state common law of contract, however, the status of the scrivener's error doctrine under the federal common law of ERISA is not well developed. In many circuits it would be hard to determine what rule a court might apply.

Second, the IRS can with justice reply that—whatever principles might apply for other Code purposes—the "definite written program" rule is a free-standing requirement of Treasury regulations under Section 401, adopted for the protection of qualified plan participants, and must be met independently.

Scrivener's Error Under the Definite Written Program Rule

We turn, then, to the validity of the IRS's position under the "definite written program" standard.

We have observed before that a number of black letter tax qualification principles lose their definite quality when the underlying terms are examined and found to be ill-defined or meaningless. And so here. In requiring that "the plan" be operated according to its terms, the IRS assumes that "the plan" is a single document—the signed, executed plan document.

The IRS has made this assumption explicit in at least one unofficial forum. At the Enrolled Actuaries' annual meeting of 1999, IRS spokespersons were asked whether failure to follow the terms of the plan's administrative procedure documents was a disqualifying error. The IRS's answer was that no disqualifying error occurred, because the documents were not the formally adopted plan document.

But this position would appear to be wrong. On the contrary, for the purposes of the "definite written program" rule (as well as for many ERISA purposes), the "plan" would appear to be the bundle of documents and practices that comprise participants' rights, and are communicated to participants. The IRS would appear to be incorrect in its single-document definition of the "plan," under both case law and its own regulations and rulings.

Even in upholding the definite written program requirement, the Tax Court has held that the requirement should be "broadly

construed to encompass various formats, including a collection of writings which creates a specific permanent plan." (*Engineered Timber Sales, Inc. v. Commissioner*, 74 T.C. at 827; *G & W Leach Co. v. Commissioner*, TC Memo 1981-91 (1981).)

The Tax Court's position that a plan is a "collection of writings" is upheld—and the IRS's current position contradicted—by the wording of the very regulation at issue. Treas. Reg. Section 1.401-1(a)(2) requires that the "definite written program" be "communicated to employees." That is, the "plan" for this purpose would appear necessarily to include the documents actually transmitted to and seen by employees. The essential nature of employee communication is affirmed by Rev. Rul. 72-509, 1972-2 CB 221, which holds that there is no "plan" for purposes of Treas. Reg. Section 1.401-1(a)(2)—even when a plan document has been drafted and executed—until it is *communicated to employees*. Moreover, regulations under Code Section 410 state that a "plan" can exist on the basis of a signed collective bargaining agreement, without a formal plan document. (Treas. Reg. §1.410(c)(2).)

Thus, the "plan" for purposes of Treas. Reg. Section 1.401-1(a)(2) is a collection of writings which must include the documents actually communicated to participants, such as the summary plan description (SPD), summary of material modifications (SMM), and other communications.

We should also note that the IRS's later regulations appear less than comfortable with the idea that "the plan" is only a single written document. See for example, Treas. Reg. Section 1.411(d)-4, Q&A-1(c)(1), which provides that a "pattern of repeated plan amendments" can in themselves create a right to a benefit which transcends any particular version of the plan document. That is, under the IRS's later thinking, even a consistent pattern of practice can be part of the protected "plan" if it gives rise to expectations among employees.

In short, the IRS's position that "the plan" is only the formally adopted document would appear to be wrong, at least for purposes of the "definite written program" requirement of Treas. Reg. Section 1.401-1(a)(2).

What are the consequences of this for our basic concern with scrivener's error? Doesn't it just multiply the number of documents that can now disqualify the "plan" under Rev. Proc. 98-22?

No.

Once it is recognized that the "plan" for purposes of the "definite written program" requirement is several documents, it may be seen

that the "mistakes" in our hypotheticals are actually patent contradictions within the same plan (a match in the plan document, but not in any material distributed to participants; loans in the loan program, but not in the basic plan document).

If there is a facially apparent contradiction among several terms of a legal document, reconciling them is an act of reformation for "intrinsic ambiguity." This is an act of *interpretation*, rather than an act of plan drafting. (See, e.g., 1 *Williston on Contracts*, §95 (3d ed. 1957); *Restatement (2d) of Contracts* §215.) The practice of plan *interpretation* is one of the plan administrator's fiduciary responsibilities under ERISA. Assuming the plan is drafted properly, moreover, a federal court is required to give deference to the administrator's interpretation. (*Firestone v. Bruch,* 489 U.S. 101 (1989).)

In short, assuming that the plan sponsor's interpretation of the correct plan provision is reflected in at least one document seen by administrators, the "plan" is no longer at variance with plan practice. Reconciling conflicting provisions of the plan is the job of the plan administrator. The IRS is without authority—either under ERISA or Treas. Reg. Section 1.401-1(a)(2)—to decide which of several provisions is the "correct" one.

No Contradiction with ERISA

While the "definite written plan" requirement predates ERISA, the Tax Court has since interpreted it in light of ERISA's purpose. It is therefore important to point out that the plan administrator's authority to construe inconsistent plan terms, which we urge should be recognized by the IRS, is consistent with courts' interpretation of participants' rights under ERISA.

The doctrine of intrinsic ambiguity has been expressly applied by federal courts to reform ERISA plans. In *Wilson v. Moog Automotive, Inc.*, 193 F.3d 1004 (8th Cir. 1999), for example, the plan provided an enhanced early retirement benefit for participants "over age 55." The collective bargaining agreement restricted the enhancement to those who were over age 55 *by December 21, 1993*. The court found that the "plan" included the collective bargaining agreement. On the basis of this contradiction between two separate terms of "the plan," the court found the plan to be ambiguous on this point, and allowed reformation of the basic plan document to include the December 21, 1993, cutoff date.

Federal courts vary in the kinds of evidence they will admit to show that a plan term is ambiguous, and therefore subject to

interpretation. But no court to our knowledge declines to interpret plans where the contradictions are apparent on the face of the plan document. (See, e.g., *Aramony v. United Way Replacement Benefit Plan,* 191 F.3d 140, 150 (2d Cir. 1999), *Cinelli v. Security Pacific Corp.*, 61 F.3d 1437 (9th Cir. 1995).)

"Definite Written Program" Is a Chimera

ERISA's drafters were concerned that participants be able to know their rights by looking at the plan document. This principle drives the limited scrivener's error doctrine adopted under ERISA by the federal courts, and the no-scrivener's-error doctrine adopted to date by the IRS. But like other policies, this one does not entirely reflect reality. Under its extended "remedial amendment periods," IRS allows plan documents to go unamended for years while IRS and Treasury staff work out the latest complexities of Congress's recently amended tax laws.

During these "remedial amendment periods" a plan can be operated at variance with those terms covered by the remedial amendment period. The most recently granted "remedial amendment period" is quite broad in scope, and would appear to permit retroactive amendments as late as December 31, 2001, for *all* "disqualifying provisions" adopted after December 7, 1994, and not just those directly affected by the new legislation. (See, e.g., Rev Proc. 98-53, sec. 2.02.) The term "disqualifying provision" is defined in regulations and generally means any provision the absence of which would disqualify the plan. (Treas. Reg. §1.401(b)-1(b)(1).)

This policy reflects a sensible perception that the tax law governing qualified plans is just too complex to administer or interpret in a hurry. But as a result of this policy, participants in fact may not have access to a complete "plan" document for years at a time. It is unclear what the policy cost is, or what extra measure of participant uncertainty is added, if some of this recognition should apply to the drafting of the plan as well.

Conclusion

The IRS requires that any difference between plan practice and the "plan" be corrected retroactively only by correcting the practice. This position appears to be based on the assumption that the "plan" is only the formally adopted plan document. We have shown this assumption to be unexamined and contrary to authority. Rather, the

plan is better seen—at least for purposes of the "definite written program" requirement of regulations under Code Section 401—as a collection of documents, including those communicated to employees. When the plan is so defined, it is apparent that contradictions among its many parts will arise, and the act of reconciliation or interpretation is a proper job of the plan administrator—not the IRS.

There is a more fundamental problem with the IRS's position, as well. We have seen that the IRS is wrong to hold that the "definite written program" is necessarily the formal plan document. And the IRS is without authority to conclude that when conflicts arise among various documents (all parts of the "definite written program") that the formal plan document must necessarily prevail over the others.

But it also seems to us that the IRS is on the wrong course by insisting that when variances between plan practice and the written "plan" (no matter how defined) arise, the only permitted correction must be to conform the plan to the writing. In addition to the plan's written documents and communications, there are other sources of the ERISA "plan." In particular, an employer's course of conduct can give rise to rights under the plan if it gives rise to employee expectations.

For example, in leading ERISA scrivener's error cases where the court has reformed the basic plan document for drafting error, the court justified its opinion in part by noting that the "correct" provision was evidenced by the employer's (and participants') subsequent course of conduct, which was at variance with the plan document. (*Mathews v. Sears Pension Plan,* 144 F.3d 461, 465 (7th Cir. 1998) (document reformed for "extrinsic ambiguity"); *International Union of Elec., Elec., Salaried, Mach. & Furniture Workers v. Murata Erie N. Am., Inc.*, 980 F.2d 889 (3d Cir. 1992) (document reformed for "scrivener's error").) A variety of ERISA doctrines (beyond the scope of this column) allow a consistent pattern of practice to give rise to plan terms, even if nowhere reduced to writing. And as we have seen, in its own regulations the IRS has suggested that a practice of plan amendments may be part of the "plan," even if the resulting "plan" provision was never itself drafted or adopted.

In conclusion: The IRS may have authority under its own regulations to insist that plan administration conform to the written plan. And even a collection of writings must at some point be reconcilable in some way as a single writing. So even under an expanded definition of what comprises the written plan, it is predictable that, in some instances, variances between practice and writing may still persist. In these circumstances, we question whether it is always the practice that must be corrected retroactively, and not the writing. More

fundamentally, we question whether the "plan" must always be the written document (or documents), rather than the practice. Federal courts don't think so, participants don't always think so, even the IRS in its own regulations doesn't always think so. By insisting otherwise in its voluntary correction programs, the IRS would seem to us to be on a collision course with the still-emerging definition of what comprises the "plan" for purposes of ERISA and the Code.

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