Note - Any federal tax advice contained in this transcript is intended to apply to the specific situation described and should not be considered official guidance independent of the presentation. The tax advice and statements contained herein should not be relied upon for retirement planning purposes without first consulting a tax or retirement planning professional. This transcript has been edited for technical accuracy and may differ slightly from the audio recording of the "EPCRS: Correction of 401(k) Plan Mistakes." This information is current as of July 25, 2013. Since changes may have occurred, no guarantees are made concerning the technical accuracy after that date.

Mark: Hi, everyone. I'm Mark O'Donnell, Director of IRS Employee Plans Customer Education and Outreach. Welcome to our "EPCRS: Correction of 401(k) Plan Mistakes" phone forum.

Today, we'll be hearing from Avaneesh Bhagat, Voluntary Compliance Group Manager, and Stephanie Bennett, Voluntary Compliance Program Coordinator. Thank you for joining us today.

Before we start out, I'd like to point out a couple of things. Everyone registered for this forum will receive a certification of completion via email in about a week as long as you attend the entire live forum. Enrolled agents, enrolled retirement plan agents and enrolled actuaries are entitled to continuing education credit for this session. Other types of tax professionals should consult their licensing organization to see if today's session qualifies for continuing education credit.

As with all of our presentations, the comment expressed by our speakers should not be construed as formal guidance from the IRS.

We have an array of retirement plan resources available for you. For more information regarding 401(k) plans, visit our retirement plans website at www.irs.gov/retirement, also see Slide 2 of the handout. You can also get there by going to the main IRS.gov's landing page, click on the "Information For" dropdown box in the upper right-hand side of the screen and select "Retirement Plans." Then, look to the left-hand navigation bar, select "Type of Retirement Plans" and choose "401(k) Plans."

While you're visiting our website, you might also want to subscribe to our free electronic newsletters. To subscribe, select "Newsletters" in the left-hand navigation bar, choose "Subscribe" and then select "Retirement News for Employers," our newsletter for employers sponsoring retirement plans and "Employee Plans News," our newsletter for retirement plans professionals.

Let's hear from other news from Avaneesh and Stephanie.

Stephanie: Thanks, Mark. I'm just going to go ahead and get started. The focus of today's presentation is correcting 401(k) plan issues. The handout for today's presentation is a PowerPoint presentation and it's available at the IRS website and you should have been able to get a copy of that if you registered for the phone forum today.

The first thing we're going to discuss is the information in the PowerPoint slides. We may do that in a somewhat summary fashion so we have sufficient time to address the questions we received, which were emailed to us prior to the phone forum.

I'm going to be covering information in the first 13 slides, so if you want to follow along, please do.

The goals of this session are: to provide you with a brief overview of the updates made in Revenue Procedure 2013-12 that impact 401(k) Plans; and to discuss common 401(k) failures and correction approaches for fixing those failures.

Before we delve into our discussion of 401(k) correction issues, it's probably best to take a step back and provide a brief overview of the Employee Plans Compliance Resolution System correction programs.

There are three programs that form the Employee Plans Compliance Resolution System and the rules for that are covered in Revenue Procedure 2013-12.

Those three programs are:

First, there's the Self-Correction Program, which allows you to correct certain problems on your own without actually getting formal IRS approval for it.

Then, we have the Voluntary Correction Program or VCP and it requires a formal submission and a payment of a fee to the IRS where the plan sponsor would identify a problem and would propose a correction for that problem to the IRS. Once we received that submission and we approved the correction for that failure, we issue a compliance statement to the applicant.

The advantage of getting the compliance statement is that if your plan is later audited, assuming that the facts you presented in your initial submission were accurate, your compliance statement protects the plan from disqualification for the particular issues that are covered under that compliance statement — those issues that you disclosed in your failure and the proposed correction method that you outlined in your submission.

Finally, the third piece, the Audit Closing Agreement Program or Audit CAP, we often call it. That allows plans to correct problems with the plan that's under IRS examination.

That's the rundown of the basics of the three programs. Although each program is different, the goal of all three programs is: to preserve the tax deferred benefits for participants. In other words, it's preserving the tax-favored treatment that those plans are able to take advantage of; and to provide income/excise tax relief in certain situation.

Now that we've discussed the overall correction programs, it's important to mention the guiding correction principles under those programs.

One of the principles is that full correction of a failure includes all taxable years, even if the taxable years are closed. If you submit a submission and you bring a failure in under VCP and that failure … Let's say, for example, the plan left out amounts of pay that should have been included, if you look at the plan's definition of compensation, and that failure occurs for the 2004 to the 2012 plan years. Under this guiding correction principle, your correction proposal should not just address a portion of that period. You can't just disclose that the failure occurs in the 2004 to the 2012 plan years and only propos correction of the 2009 to 2012 plan years. Instead, your proposal should address all years of failure.

Another correction principle is that the correction proposal should restore participants to the position they would have been in if things were done correctly. In the example that we've just discussed regarding the improperly excluded amount from compensation, those participants would need to be put in the place they would have been in if the plan followed the definition of compensation. So, if the plan was operated in accordance with the terms, where would those participants be?

Another correction principle is that the proposed correction should be a reasonable and appropriate for the failure. There are guidelines in the Revenue Procedure for determining whether a correction is reasonable and appropriate. They include that the correction of it should resemble a correction method already provided in the code, if possible. They should keep assets in the plan and not violate another code requirement. If the failure you're disclosing is a non-discrimination failure, the correction method should provide benefits to non-highly compensated employees.

Just to step back, if you propose a correction method outlined in Appendix A or B, those correction methods are deemed to be reasonable and we often refer to those as safe harbor corrections.

Now, we're going to transition, we're going to move over to a quick discussion of the recent updates that were made to EPCRS with the release of Revenue Procedure 2013-12.

As I've mentioned earlier, the Revenue Procedure that governs EPCRS's programs, it's in Revenue Procedure 2013-12. It replaced Revenue Procedure 2008-50 and provided updates that impact 401(k) plans in addition to adding correction principles for 403(b) plans. It also provided new submission requirements.

The new submission requirement includes filing all submissions in Covington, Kentucky instead of DC and it also includes two new forms, the Form 8950 and Form 8951.

Now that we have all of that behind us, let's discuss some of the changes in the new Revenue Procedure that affect 401(k) plans.

One of those changes involves the correction of the failure where the plan sponsor mistakenly left out employees who are eligible to participate in the plan. The correction in the 401(k) plan involves making a corrective contribution in the form of a QNEC on behalf of those individuals to make up for the missed deferral opportunity.

If the plan provides for matching contribution, the corrective contribution for the missed matching contribution are equal to the match the employee would have received on the entire missed deferral contribution.

One update in the new Revenue Procedure is that the corrective contribution for the match can be made by a corrective matching contributions instead of a QNEC. That corrective matching contribution would be subject to the plan's vesting schedule.

We're moving now to another change, to the safe harbor correction method for excluded employees is the addition of a safe harbor correction for the exclusion of a participant from the safe harbor plan under code Section 401(k)(13).

Just to step back, a safe harbor 401(k)(13) plan is a qualified automatic contribution arrangement plan under which the plan provides a 3% minimum deferral for automatically enrolled employees and that rate automatically increases by one percentage point each year up to at least 6%.

Under the safe harbor correction method, if an employee is excluded for a period that does not go beyond the last day of the plan year in which the deferral should have been made, but for the failure of the missed deferral, it's 3% and if the failure goes beyond that plan year, then the percentage is escalated in accordance with the escalation provisions in the plan to comply with 401(k)(13).

Another clarification, in the new Revenue Procedure that impacts 401(k) plans is that when correcting a failed ADP, ACP or multiple use test under the safe harbor correction method in Appendix A, the amount used to fund QNECs may not include forfeitures. This is a position we have taken in the past, but now the Revenue Procedure formally outlines this. This is in line with the definition of QNEC and Regulation 401(k)-6 and that regulation requires that such amounts be fully vested when they're contributed to the plan. Now this is formalized and is actually in the Revenue Procedure itself.

Another update that was made in the new Revenue Procedure addresses correction of overpayment failures in defined contribution plan. The update to the correction of an overpayment failure involves one of the correction steps. To correct an overpayment failure, the employer needs to take reasonable steps to recover the overpayment adjusted for earnings from the participant or beneficiary of the plan. If the amount recovered is less than the overpayment amount adjusted for earnings, the employer or another person must contribute the difference to the plan.

So, the second step in the correction, which is the repayment of the overpayment amount to the plan. It was revised in the new Revenue Procedure to add an exception to the obligation to repay. That exception to the repayment step in the correction applies in cases where the failure involved the payment to a participant in the absence of a distributable event, but the amount that was paid out to that participant was otherwise in line with the plan terms. In other words, in the case of an impermissible in-service distribution, the employer does not have to repay the plan the overpayment amount assuming, of course, that the amount paid out was otherwise determined in accordance with the plan.

Now we're going to move over to a change that impacts the Self-Correction Program and that's on Slide 12. Prior to 2013-12, in order to use the Self-Correction Program, the plan would have to have practices and procedures in place to prevent code Section 415 to have been exceeded to begin with. So, you had to have practices and procedures in place to guard against going over that limit.

There are certain situations where if you have plan that had an elective deferral and non-elective contribution. In those situations, the plan sponsor would make employer contributions without taking into account elective deferrals and then correct for 415 if they exceeded the 415 limit by first distributing from elective deferral after the year end.

The advantage of that setup is that the employee is able to keep a larger share of the employer contribution money than if the plan monitored elective deferrals and had the employer limit employer contributions to comply with the 415 limit. So, more of the money staying in the plan is employer contributions and so the current Revenue Procedure addresses this scenario.

In that situation, the plan that provides for elective deferrals and non-elective employer contribution that are not matching contributions is not treated as failing to have established practices and procedures to prevent the occurrence of a Section 415(c) violation in the case of a plan under which excess annual additions under 415(c) are regularly corrected by return of elective deferrals to the affected employee within two and one-half months after the end of the plan's limitation year. If there's a recurring violation of this, but as long as you correct them within two and a half months, you are viewed to have practices and procedures in place so you could still self-correct.

Another change — and we're on Slide 13 right now — is that the new Revenue Procedure was modified to reflect that as of August 31st of last year, the letter forwarding program is no longer available to help locate missing plan participants. With that in mind, the Revenue Procedure was revised to provide some method that can be used to find lost participants such as using a commercial locator service, the Social Security letter forwarding program, using credit reporting agency, or Internet search tools.

If you want to know more information about the letter forwarding program, you can look at the Revenue Procedure 2012-35. Before I step away from that, it's important to know that similar to 2008-50, a plan is not considered to have failed to correct if they are unable to locate an individual. As long as the applicant, the plan sponsor takes reasonable steps, reasonable action to locate the individual, and that additional benefits are provided to that individual if the individual was later located then you've taken your steps, you're okay. You don't actually have to find the individual, you just have to take steps to try to locate them.

Now I'm going to turn it back over to Avaneesh to finish up the PowerPoint slides and then after that, we're going to turn over to questions. I'm going to turn it over to Avaneesh.

Avaneesh: Thank you, Stephanie. Okay. We'll shift gears likely now from the overall correction procedure and what's the governing Revenue Procedure, the rules associated with that and the corrections that are associated with coming up with ways to fix problems and preserve the tax deferred status of qualified plans, including 401(k) plans. What we're going to do now is shift gears to failures that are specific to 401(k) plans.

If you'll look at Slide 14, there's a website that we have for 401(k) Fix-It Guides. This is a supplement to the Revenue Procedure. What that does is it takes a holistic view of plan corrections. It's not just limited to one of the common failures and what's the correction, although those two things are important, but it also provides input on issues like how do you find a problem? Because you have to find a problem first before you can fix it and then what things could you do to avoid the problem in the future.

Hopefully, if you're able to take those steps ideally, we at the Voluntary Compliance Program should be put out of business and try to do other things. But basically, it takes a pretty holistic approach of how do you find the problem, how do you fix the problem, and then how do you avoid a problem going forward?

If you'll look at 401(k) failures as a whole, you could probably categorize them into two large categories.

The first would be the failure to update plan documents. As you all probably know, the legislation in the pension area is subject to constant change and therefore their deadlines to update your plan documents to reflect current legislation. Those are deadlines that are commonly missed and therefore those errors, if they occur, are things that can be addressed.

Of course, even if you have a perfectly good plan document you always have the potential of the failure to follow the plan's the terms, to operate the plan according to its terms. There could be a number of the areas that can be impacted by that. The common ones are: issues of compensation; issues of excluding eligible employees; making hardship distributions; loans and violations of the terms of the plan. Sometimes the plan may not even be allowed for those things but they were permitted. Issues like that that come up as a result of the administration of the plan.

That gives you a flavor of the kind of failures that occur. Now, what I'll do is … Let's take a look at Slide 16, which deals with the plan document aspect of things.

To give you a flavor of what the Fix-It Guide does. First, it gives you a hint in terms of what do you do to find plan document mistakes. It tells us that we should look at, in essence, the document trail. What plan documents existed over a period of time and it includes the original plan documents subsequent amendments, restatements, adoption agreements, any opinion letters issued for the plan, any determination letters issued for the plan. That should give you a hint whether any gaps exist or whether the plan historically has been timely amended to reflect to the different pieces of legislation. Once you look at that trail, you can figure out if there are any gaps and then make corrections if needed.

What do you do if you find out there are gaps? One approach would be to basically look at where the gaps are and if you find that you don't have documents in file that would show that the plan was amended or restated for the particular piece of legislation, you may want to adopt those corrective amendments and then submit it and make it a part of a submission under the Voluntary Correction Program. If we accept those amendments, then, in essence, you'll be treated as if you adopted those amendments timely and therefore, for the piece of legislation you're back on track.

If you move on to Slide 18, — and again, I'm going to pick and choose slides as we go — it provides advice on what can we do to avoid plan mistakes.

The first approach is to maintain plan records and maintain them for a lengthy period of time. Don't just stop after two or three years because the more records you have, the more of a handle you'll have as to whether the plan was historically amended or updated to reflect pieces of legislation or even whether you have a plan document in existence as of its effective date. So, the key thing there is that you need to maintain those plan document records for many years going forward.

There should also be frequent interaction between the employer and the service provider. Because that way there would be constant reminders as to when these documents should be signed or restated and also, with frequent communications, you make sure that the service provider is able to draft something that both complies with the legislation and also reflects the employer's intent in terms of the kind of benefits it wants to provide under the plan.

There should be a maintenance of a calendar that would provide deadlines by which certain amendments need to be adopted.

Points like that may be useful in ensuring that plan documents are adopted timely and you don't have the failure to begin with, which is the ideal solution.

In order to achieve that, basically all those who have a hand in the administration of a plan should be familiar with the terms of the plan. You have communications between the employers, the service providers, anybody who's involved with the operation of the plan.

If our goal is also to, not only to make sure that the plan document is current but, that the plan operated in accordance with its terms, you want to make sure that all the parties who are involved in administering the plan are familiar with the plan terms.

For example, somebody who is in payroll and is in charge of administering the deferrals with respect to the participants should know the definition of compensation — that is, what's included and what's excluded — for calculating what the employee's elective deferral would be.

Also, now that you have so many aspects of the operations that are systems-dependent, for example, the implementation of auto-escalation and auto-enrollment plans, you also need to from time to time probably pay attention to the systems in place to make sure that they are designed properly to implement plan terms.

These are the kinds of things that you'll find in the Fix-It Guide.

Let's just shift gears a bit and talk about selected correction issues. What we did was, we picked some common correction issues that occur in the administration of plans. You'll find that some of these issues that we picked have a bit of an overlap over some of the questions that you submitted into this forum. So, to that extent, it's probably relevant.

The first very common area of mistakes is in the area of compensation. You either improperly include something in compensation when the definitions of plan doesn't provide for that or you exclude something from compensation when the definition of a plan doesn't allow you to exclude.

Let's assume that the category is bonuses. If you improperly included bonuses when you weren't supposed to, you could probably, assuming there's no discrimination and obviously here the plan is operating more generously than what the plan document says so you won't have a cut back issue, you might be able to submit an amendment to Voluntary Correction and get the problem resolved that way. Otherwise you would have to implement an operational fix, which would involve distributing excess deferrals attributable to bonuses and forfeiting any related employer contribution as in employer match related to those deferrals. That would be the deal if bonuses were improperly included when it shouldn't.

The other example is sometimes a little bit more complicated. Sometimes you will have an adoption agreement where maybe employers checked the wrong box and you're thinking that they checked the box that would require the inclusion of bonuses that never intended to. Many times you would get a submission in that would just say, "Hey, can you just approve an amendment and eliminate that checked box items so that we could exclude bonuses based on what the employer's intent was?" That's not so easy to do because the presumption is that you have a signed plan document in place and therefore its terms should be followed. Therefore, the default position is always going to be that if you check bonuses in the plan document and even if you administer in a way that excluded bonuses, we're not just going to approve that. We would actually require corrective contributions for those amounts attributable to the bonuses so that would mean corrective contributions for missed deferrals equal to 50% of the elective contribution percentage for the bonus piece of compensation and any related matching contributions and if there's non-elective employer contributions involve you would have to be able to deal with that as well.

That's the common operational issue that occurs. Let's shift to Slide 29. Here's another issue that's now becoming more and more common as plans implement the automatic enrollment feature. A lot of times you have a situation where if an employee does nothing the plan provides for an automatic "negative election," if you will, and sometimes that negative election is not implemented. In that case, then the employer would have to make corrective contributions for the missed deferral based on the assumption that the negative election was the employee's choice of elective deferral percentage because, in essence, that's the default unless the employee says otherwise.

That's something to pay attention to as automatic enrollment becomes more and more common.

Another area, let's look at Slide 32, which deals with the failure to provide notice in the safe harbor 401(k) plan. Here, basically, it tells you if you have that problem, in order to fashion a correction, you need to evaluate the facts and circumstances of plan to figure out what the appropriate fix might be.

The effect of the failure to provide notice is such that you've effectively excluded that employee because the employee doesn't have the information necessary to make those elective deferrals, then you would have a fix that would require corrective contributions for the missed deferrals and employer contributions, just like you would for any erroneously excluded employee.

However, if you could show that the employee was otherwise informed and the failure to provide notice was simply an administrative one but really did not have an impact on the employee's ability to defer, then it could just be an administrative issue as opposed to effectively excluding an employee from the plan and in that case, you would maybe need to provide that notice. Secondly, to ensure that you have administrative procedures to ensure that the notice is disseminated timely going forward.

The final piece in the slides that I will talk about here is, the next one, the failure to suspend elective deferrals.

A lot of times you have a case of a 401(k) plan that provides that upon receiving a hardship distribution, the participant is prohibited from making elective deferrals for six months. But, it just doesn't suspend the deferrals. The question is how to correct that and the slides go through different options, but the most straightforward option is that, in this case, since the employee was allowed to make elective deferrals that were in excess of what's allowable under the plan, the answer would be to simply return those excess deferrals to the employee and forfeit any related match and/or other employer contributions. That, I think, is probably the most straightforward approach that could put the participant a position he would have been in had the failure not occurred, had the suspension been properly carried through.

Then there are other options that are discussed and you can read those slides at a later point.

With that, I think what we should do now is shift gears to questions.

Stephanie: Yes.

Avaneesh: Okay.

Stephanie: I would just like to say thank you so much to all of you for sending questions in beforehand and we have a number of questions and we're just going to go ahead and start going through them.

One of the questions we have is regarding Roth contributions. The question is: "How do you correct an operational error where a participant was allowed to make Roth contributions to a plan that did not have a Roth provision in the plan document?

Avaneesh: The answer is, a lot the times it depends on the fact and circumstances, if let's say that your plan provided for the opportunity for Roth contributions for everybody, in that case you might be able to just solve the problem by coming into VCP and amending your plan.

Let's suppose you just offer it to targeted participants, if they were non-highly compensated employees, you might be able to achieve the same goal by amendments. If it involves highly compensated employees, you probably would probably run into the problem of providing a benefit like Roth feature that's discriminatory. In that case, then your correction would involve removing the Roth feature for those participants. So that could probably entail just distributing those deferrals back to the participants because it's based on valid elections. There could be other options as well.

Stephanie: Another question and it's on Roth as well. In this scenario, a participant elects to defer into a Roth account. Deferrals are made, but to a pre-tax account. Basically, it's a 401(k) plan that has a Roth feature and they are deferring to Roth account but they go ahead and treat it as just a 401(k) deferral. In that situation, does the participant need to get a QNEC for the missed Roth opportunity or is it enough to just unravel the mistake, unwind it and put the money in income where it belongs?

Avaneesh: I think in general, the approach would be that it should be enough to unravel the mistake and put the money in income where it belongs.

If you look at Section 2.05(3) of Revenue Procedure 2013-12, we asked for comments in this area and we have come up with three possible options for you to comment on. But as a practical matter, if you use any of those three particular options, most of which primarily involve unwinding. That is, transferring the erroneous deposited deferrals adjusted for earnings from the pre-tax account to the Roth account and then correcting the W-2 and the participant's correcting the 1040, that kind of combination. You'll see variations of that in that section of the Revenue Procedure. That should give you ideas on what kind of correction would work.

Stephanie: Okay. Here's another question. "An employer with a calendar plan, they made a mistake in their calculation of the 401(k) employer match in December 2012. This mistake resulted in matching being overstated for three of their employees. The plan has about 50 employees and they discovered this overstatement of the match in June 2013. What is the best course of action for correcting this mistake?"

Avaneesh: Basically, this is an excess allocation that was made on behalf of three employees. You would forfeit the excess match with earnings made on behalf of the employees and transfer them to an unallocated forfeiture accounts and then use those money in accordance with the plan's forfeitures.

For example, if the plan provides that forfeitures are used to reduce employer contributions, then those amounts that were forfeited will be used towards funding, coverage of future employer contributions before any of the contributions are made.

Stephanie: Okay. Here's another question. "What is the correction when salary deferrals are contributed to the plan in excess of the participant's election? For example, deferrals are withheld from ineligible compensation or the participant's elect a reduction in deferrals and that reduction is never implemented.

Avaneesh: Let's just say you have a situation where you have excess deferrals made to the plan and those amounts should then be returned to the participants and reported on the 1099-R the corrected distribution that is taxable and non-eligible for rollover.

Stephanie: Okay. There's a follow up question on this. "If the excess deferrals are not reported on Form 1099-R and the excess deferrals relate to a prior year, should the plan sponsor issue an amended W-2 for all effective years, which would cause the participant to have to file amended personal tax return?"

Avaneesh: Yeah. That seems like [crosstalk 00:34:54].

Stephanie: Okay. So, yes. Here's another question. "If a plan missed stopping the participant's deferral contribution for six months after the participant took a hardship withdraw, how can they correct?" We were just talking about that when we're going through the slide.

Avaneesh: Yeah. Forfeit the deferrals and any associated matching contributions.

Stephanie: "How do you remove those deferrals?" That's the follow up question.

Avaneesh: All right. Distribute the deferrals directly to the participant's issue a 1099-R and again it's a taxable distribution and not eligible for a rollover.

Stephanie: Okay. Now we have a question about earnings. This is a plan with a qualified automatic contribution arrangement. The provisions in the plan include quarterly automatic enrollment, they invest the automatic enrolled individuals by default into a Qualified Default Investment Alternatives or QDIA. They are asking, "What is the appropriate rate of return in this situation to use for correcting lost earnings due to the missed opportunity to enroll.

Avaneesh: Basically, if you're going to use estimates, the average rate of return is always a good estimate because in essence you're looking at what the … people who were probably enrolled and were able to make investment choices, the average of what they all did that's a good proxy. But in many case situations, the QDIA could be good too because if you look at the experience of the automatic enrollment in many cases, if that money is invested in QDIA and your plan basically has a situation where most of the enrollees don't really make changes from the QDIA, the QDIA could have been a good proxy as well.

I think just evaluate the facts and circumstances and come up with an estimate that gets you as close as possible to where the participants would have been in had you've been properly enrolled or timely enrolled.

Stephanie: Okay. The next question I have, is about the de minimis rule. What they want to know is that, "If there's a contribution error that only affects prior terminated participants and they no longer have an account balance in the plan. They're the folks who took a cash out when they terminated and they have no balance in the plan; they may not even have an account. In this situation, does the $75 exclusion rule apply. Does the contribution error become a distribution error in this situation by default because the participant no longer has an account balance and they're no longer working for the employer? "

Avaneesh: The answer I think in this case is yes. If the participant has terminated and the corrective contribution would be immediately distributable, then you can extend the de minimis rule to that corrective contribution.

Stephanie: Why?

Avaneesh: Because otherwise if that corrective contribution was made and then you apply de minimis rule to the distribution, that money never reaches the participant.

Stephanie: Right, it's just in the plan.

Avaneesh: I think you could have that move extended to the corrective contribution piece in this situation.

Stephanie: Okay. We have question on loans here. The first question here is "If an employer withholds loan payments from an employee's paycheck but fails to remit those payments to the plan timely." The first part of the question is, "Should lost earnings be funded for the late loan payment same they do for deferrals and match?"

Avaneesh: Yeah. You would use the greater of the plan rate of returns or interest rate on the loan. That way, what you're trying to do is both get the loan current and what you also what to do is get the participant's account balance to where it would have been had the payments been made timely.

Stephanie: Okay. Follow up question here is, "If the loan, in this situation, goes beyond the cure period and past the default date as a result of payments not being remitted, so somebody didn't make any payments. Do the loans still get defaulted even though the payments were withheld from the check?" I think this is a pretty short answer.

Avaneesh: The answer is yes, unless you're able to correct it using the VCP program.

Stephanie: Okay. We have another one on loans here and this is a fee issue here. They're basically saying, "Loans that are in default as a result of missed payments are only correctible through the VCP program and the fee for the VCP program would apply for instances where one participant's payroll deductions were missed for a short period." So you have one loan failure with respect to the plan. They want to know if there is a reason that the self-correction method is not available for these types of oversights

Avaneesh: The answer varies. Anytime you have a goal of getting some kind of income tax or excise tax relief, outside of just preserving the qualified status of the plan, you need to come in and ask for that relief.

Let’s say, you have a situation where you use it for loan failure but it’s pretty large plan and so you don’t really want to pay that high VCP fee to correct that isolated loan failure. If you’re not worried about getting relief from the 72(p) tax liability, then in that case, you don’t have to come in, you could probably self-correct the loan itself to bring it in accordance with plan terms. At the same time, the participant would be liable for the income tax when the loan defaulted and you have a deemed distribution.

Let’s say, the employer just would want to work out a deal where they want to compensate the employee separately for that additional tax liability, they certainly could and then correct the loan. I think the reason why VCP would be required would be if your goal was, in addition to preserving the qualified status, you also wanted to get relief from the 72(p) income tax consequently.

Stephanie: Then you have to come in and you’re going to have to get a compliance statement to give you that relief. You can’t do that under self-correction.

Avaneesh: Yup.

Stephanie: Okay. Someone here wants to know, “How do they correct for a person who is allowed to make a deferral to a 401(k) too early before meeting eligibility?” Basically, it’s early inclusion of an otherwise eligible employee but they just have not met the plan’s eligibility terms. How would you correct--

Avaneesh: Simply return the excess deferral to the employee and forfeit any related match. That would again bring the employee in the position he would have been in, which would have been basically zero account balance until he was eligible. That would be one option.

Also, the Revenue Procedure also does give you the facility to simply amend the plan to include those who basically would otherwise be eligible but just in the agent’s service requirement or the entry gate requirement into the plan. In that case, then you don’t really need to make a correction, you could just simply amend it and that’s available on the self-correction piece. [Inaudible 00:42:28] with self-correction is available without having to come in to VCP.

Stephanie: Okay. This is a very similar question, you may have slightly answered it with the prior question, but I’m just going to go ahead and read it. The question is, “They determined that a couple of employees who were not eligible to participate in the plan were erroneously allowed to defer to the plan. But in this scenario, the some of the employees should not have been included because they didn’t meet the age and service requirement and there may also been employees deferring in the plan who were otherwise in an excluded class of employee so they should never have come into the plan. They want to know if it’s an appropriate corrective option to return the deferrals plus appropriate gains and losses directly to the participant and issue a 1099-R for the year the fund was distributed. And this is a short answer.

Avaneesh: Yes.

Stephanie: Yes, that's an appropriate correction. Moving onto the next question. In this case, the individual is Schedule C filer and they're the only person in the 401(k) and they are asking, "Do I have to deposit by January 30th of the following year?" And then they go on to provide the facts, they said, "I waited until now under extensions to decide to adopt the solo 401(k) plan?" And they determined it was a good idea at that point.

Avaneesh: Okay, so there are two issues here. The first issue is the deadline to establish the plan. The plan must be established by the end of the employer's tax year. If you missed that deadline then you can't make a contribution of 401(k) contribution for that time year. Let's assume that it was timely established, in that case, you have the due date, you have the due date set for the tax return, including extensions if you file those to make a 401(k) contribution for that year. But the critical piece of it is that, since you were still deciding whether you need to have a 401(k) plan in place, in that situation you're probably out of luck because the plan has to have been adopted by the end of applicable tax year, there's no extension to that.

Stephanie: Right. If you wait too long to adopt you can't make those contributions. All right. Here's the next question. In this scenario, the employees were allowed to make elective deferrals from severance pay in error and the plan definition of compensation doesn't allow deferrals from severance pay. So they're asking, "What is the appropriate corrective action for the employee who has assets remaining in the plan?" And then there's another question, "What's the appropriate collective activity for an employee who subsequently rolled the assets over to an IRA?"

Avaneesh: Okay. If the assets are still on the plan, the appropriate corrective action would be to remove the deferrals from employee's account, distribute it to the participant, and of course, work with any the related matches, if there was any.

For the employee who rolled those amounts into an IRA, you first have a notification process where you need to notify the individual that these amount weren't eligible for deferral and also that there are tax consequences if you kept the money, roll those money into an IRA, this includes the tax consequences under 4973.

To summarize, you try to get that money back, if you can, and if you weren't successful in getting that money back, at least notify the employee that those amounts are not eligible for a rollover otherwise you are responsible for tax consequences that result from that.

Stephanie: Okay. This is a question we do get from time to time and it's related to documenting of self-correction of failure. The question he's asking is, "Is there a suggested internal memo or form that the plan sponsor should create to document the failure, the correction, the rationale for the correction approach, et cetera, if they decide to self-correct? How should they document them?

Avaneesh: Okay. We don't have a prescribed form but we definitely agree with the suggestion that the failure should be documented. Whatever you do, come up with something that would document why you think you're eligible for self-correction. For example, if you're having to make a decision as to why the failure is significant or insignificant, evaluate those factors and document that as soon as possible.

Also, if needed, if you're not using one of the safe harbor correction methods, document the rationale for your approach to correction. I think you should do it as soon as you discover it and on the process of correction because a lot of times there could be timeline between when you actually fixed the problem and when, say, a plan could come into examination in the future in which case you may not remember the facts and circumstances that clearly.

Stephanie: Okay. All right. Here's another question, this is a single employer plan and they have several participating several adopting employers and they all share common ownership. Some of those employers were allowed to enter the plan based on the plan document and eligible employees were enrolled correctly. However, they never went ahead and executed the participating employer agreement until much later.

Avaneesh: In this particular case, in essence, the consequences that, if we don't fix that you have the eligible employer's employees participating in the plan when under the plan's terms they shouldn't have been able to, right?

Stephanie: Right.

Avaneesh: In this case, you could probably come in under VCP and request approval of an amendment that would involve the addition of this employer and based on facts and circumstances, we could evaluate that and possibly approve that. One of the key issues we would evaluate is how long will the employee participating in the plan and also you want to make sure that there are no discrimination or cut back issues. Meaning, if you adopt that amendment, you're not creating some of the qualifications problem. Just take those into consideration but you could have the corrective amendments evaluated under VCP.

Stephanie: Okay. We have a compensation question. Basically, they excluded bonuses from compensation but the plan definition of compensation did not exclude bonuses. They say that it was intended of course to exclude bonuses even though the plan document says otherwise. They found out about this in 2011 and they came in and they corrected this just for the 2011 plan year under VCP. They say that in 2012, it was handled correctly. But this is an odd situation because they say that there's a period of about four years prior to the 2011 year when bonuses were being excluded from compensation even though the plan definition says that they should be included. Basically, they corrected for one year but they got four additional years prior to that 2011 plan year and they're wanting to know, "Hey, can we do anything rather than come in under VCP to correct those earlier years?"

Avaneesh: I can't think of an option outside of VCP in this case simply because, in part, their correction would involve amending the plan. In most cases, once your correction involves amending the plan to reflect operation, then probably VCP becomes the only option.

Stephanie: Okay. It seems like what they want to do here is they want to amend the plan to reflect their operation. Okay. The next question, "Is there any requirement that the plan has to clear/allocate/distribute forfeiture accounts annually?" We get this question quite a bit. They say often the plan document indicates that a plan sponsor will use the forfeitures to reduce employer future contributions, but they have not been doing that because they have not been making contributions due to the economy so the forfeiture account is accumulating.

Avaneesh: You would have a potential qualification issue. I guess, one way that you could consider looking at this is Revenue Ruling 80-155 that addresses the forfeiture issue and it provides that the plan will not be qualified unless all amounts are allocated to participant accounts in accordance with a definite formula in the plan. So, if you carryover the forfeitures you're violating that provision. That's the qualification implication of that. To correct it, you probably now want to take steps to allocate those amounts.

The ideal scenario would be to try and allocate those money to those individuals who should have gotten an allocation of those forfeitures had the forfeitures been properly disposed when they should have been.

That's something that I think you should look at. There are issues sometimes data issue for prior years, in which case, the attempt should be to still try and get as close as possible to allocate to the people who are employees during the period in which the forfeit is …

Stephanie: Okay. Now we have another question here, "Is it ever acceptable to transfer small balances of employee contributions into the forfeiture account?" Basically, they want to forfeit small account balances.

Avaneesh: I'm not aware of any situation where you can forfeit an account balance, an existing account balance regardless of size. I can't think of any other scenario.

Stephanie: Okay. This is another question, "If an employee completes the salary reduction agreement to stop deferrals to the plan and the employer doesn't implement the revised salary reduction agreement, is it inappropriate for the employer to ask the participant if they would like to leave their money in the plan or must the deferrals be returned to the participant?"

Avaneesh: Based on employee's election, the amount should be distributed.

Stephanie: Okay. Here's another one, "Due to an acquisition, we implemented a new 401(k) plan. The new plan was implemented on March of 2013. Is the annual federal contribution limit

17,500 for 2013 applicable for contributions under each plan or the total of both or the new plan?

Avaneesh: The contribution limit, which is under Section 402(g), the 17,500 typically, is an individual limit. That limit applies regardless of the number of times an individual participates on that has the selected deferral feature. There could be plan sponsored by the same employer or plan sponsored by unrelated employer. It doesn't really matter if you have multiple 401(k) plans that you're participating in or just one. It's the same overall limit of 17,500 that would generally apply.

Stephanie: Okay. We have a plan document question here. They have a plan sponsor that failed to timely adopt one or more required interim amendments and they would like to correct their failure under VCP. To correct that failure, must the plan sponsor adopt a stand alone amendment for each interim amendment that they missed, or can they just adopt their up-to-date preapproved plan document that has all that language in it and correct for those missed interim amendments?

Avaneesh: I think what you could do here is, you could adopt that preapproved plan document but just for administrative ease what you may want to do is highlight the spots in which those interim amendments failures were addressed in the plan document. Please just don't submit a plan document and just say it's in there somewhere.

Stephanie: All right. So, a clue as to where the corrective language is in the plan document — page number, section — that would help us out when we're reviewing the submission.

What cumulative list should be referenced for determining whether the reduced $375 filing fee applies for preapproved defined contribution plan? They're saying, for example, they discovered that their preapproved plan was not timely … it was timely restated for EGTRRA by the April 30, 2010 deadline but they never amended for 415. Are they eligible to get the $375 reduced fees for the submission right now?

Avaneesh: Okay. Preapproved plans were reviewed for compliance for the 2004 cumulative list and so that's the latest cumulative list for which plans were approved for. That cumulative list does not address the 415 regulations that came in later starting with the 2006 cumulative list. The amendment would still be categorized as an interim amendment because the cycle with respect to that amendment has not expired and therefore you can … since you only have that failure, you can use Schedule 1 and pay the reduced $375.

Stephanie: Okay. So we have a successor plan question here. They have a scenario where an acquired company's 401(k) plan assets were transferred to a successor plan. The original plan assets included safe harbor match accounts, which were mistakenly put in the other plan's matched account, even though it wasn't a safe harbor matching plan and some participants have subsequently taken distributions from this account that would not have been allowed if it was properly designated as a safe harbor matching amount. They're asking, "Is it proper correction to treat the distribution as an overpayment under 6.06(4) of the Revenue Procedure and ask the participants to return the distribution?"

Avaneesh: Yes.

Stephanie: The follow up question is, if they do not, would the plan sponsor be relieved of the requirement to contribute a make whole contribution because the failure was a payment made in absence of distributable event.

Avaneesh: I think here, as long as it's coming out of the employee's vested account balance, meaning other participants would have been negatively impacted as a result of that, the plan sponsor would be relieved of the requirements to make a contribution or to make whole contribution for that.

Stephanie: Okay. Another question, what is the appropriate correction method for governmental 401(a) plan that's not intended to include cash deferred arrangement but they violated the one-time irrevocable election requirement by allowing participants to modify elections each year?

Avaneesh: Okay. Basically, here, what you would have is a situation where you have an improper CODA going on and also you're violating the terms of the plan.

The way I would look at it is, if you look at the irrevocable election requirement, the reason why an irrevocable election is not considered a CODA is because that decision is made and now the employer are trying to make those contributions directly to the plan so the employee doesn't have the cash option with respect to those contributions. So, very analogous to employer contributions that should have been made a money purchase plan. Just looking at it from that light, as if that contribution was a money purchase plan contribution, then you can evaluate what the correction is.

If an employee elected and contributed too much, you would probably return that excess deferral back to the employee, and of course it's taxable. If the employee deferred too little, then the employer would have to come in with difference. Again, there's little 50% thing here because basically the employer is committed to make that money purchase plan contribution so the employer would contribute the difference. So, two purposes, bringing the plan in compliance with its terms and also, in essence, eliminating the CODA feature.

Stephanie: Okay. "Does the new Revenue Procedure 2013-12 require that missed matching contributions arising from a missed deferral opportunity now be funded in the matched source instead of a QNECs?

Avaneesh: Yes. Missed matching contributions were, only if we excluded the employee can be made by making a corrective contributions that is subject to the plan's vesting schedule to make up with those missed matching contribution instead of a QNEC.

Stephanie: Okay. All right.

Avaneesh: Thanks everybody for participating in this. We enjoyed doing this forum and we hope you got something valuable from this as well. So, from the presenters' side, this forum ends. Thank you.

Stephanie: Thank you.