



## ***Plan Corrections***

*The Employee Plans Compliance Resolution System (“EPCRS”)*

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# Retirement Plan Resources

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- Retirement Plans Website – [www.irs.gov/retirement](http://www.irs.gov/retirement)
- 401(k) Plans – from the Retirement Plans website, look to the left-hand navigation bar, select “Types of Retirement Plans,” and click on “401(k) Plans.”
- Newsletters – from the Retirement Plans website, 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.



# Agenda

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- EPCRS Update and 401(k) plans
- 401(k) Common Failures (Find, Fix, Avoid)



# EPCRS correction programs

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- EPCRS consists of three correction programs
  - Self-Correction Program (SCP)
  - Voluntary Correction Program (VCP)
  - Audit Closing Agreement Program (Audit CAP)
- Goal:
  - Preserve tax deferred benefits for participants under § § 401(a) (qualified plans), 403(b) (tax-sheltered annuities), 408(k) (SEPs and SARSEPs), 408(p) (SIMPLE IRAs)
  - Income/excise tax relief: § § 72(p) (loans), 72(t) (early distributions), 4974 (min. distributions), 4972/4973 (excess contributions), 4979 (ADP/ACP test)



# Correction Principles

ref: § 6 of Rev. Proc. 2013-12

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- Full correction includes all taxable years, whether or not the taxable year is closed.
- The correction method should restore the Plan and its participants to the position they would have been in had the failure not occurred.
- The correction should be reasonable and appropriate for the failure.
  - Appendix A/B - correction deemed to be reasonable
  - Other: Consistency with the IRC; provide benefits to NHCEs; keep assets in plan



# EPCRS Rev. Proc.

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- Current Revenue Procedure: Rev. Proc. 2013-12 (generally effective April 1, 2013)
  - Significant changes
    - Update correction principles for 403(b) plans to reflect the written plan requirement and other aspects of final 403(b) regulations
    - Revisions to the submission procedures under VCP e.g. filing applications with KY instead of DC, use of forms 8950 and 8951, availability of model Appendix C compliance statement.
    - Other changes including some that impact 401(k) plans



# Erroneously excluded employees

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- Appendix A, section .05 and related examples in Appendix B were revised to generally provide that:
  - matching contribution owed to a participant may be made in the form of a corrective employer matching contribution, instead of a QNEC.
  - corrective employer matching contribution (unlike a QNEC) would be subject to the vesting schedule under the plan that applies to employer matching contributions.



# Erroneously excluded employees

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- Appendix A, section .05 was revised and expanded to add safe harbor corrections relating to the improper exclusions of employees from safe harbor 401(k) plans under sections 401(k)(13), 403(b) plans and SIMPLE IRA plans.
- The Rev. Proc. 2008-50 correction for 401(k)(12) plans carries forward to Rev. Proc. 2013-12.



# Erroneously Excluded Employees contd..

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- 401(k)(12)- missed deferral is deemed equal to the greater of 3% or the maximum deferral percentage for which the employer provides a matching contribution rate that is at least as favorable as 100% of the elective deferral made by the employee.
- 401(k)(13)- if failure occurs for a period that does not extend past the last day of the first plan year which begins after the date on which the first deferral would have been made (but for the failure), then the missed deferral is deemed equal to 3%; if the failure occurs during a period subsequent to that- then the missed deferral for each subsequent year is equal to the qualified percentage specified in the plan document to comply with § 401(k)(13)(C)(iii).



## Funding of Qualified Nonelective Contributions (QNECs) ref: section 6.02(4)(c) ; App A .03

- Clarifies that for purposes of correcting a failed ADP, ACP or multiple use test, any amounts used to fund QNECs must satisfy the definition of QNEC in § 1.401(k)-6.
- This regulation does not allow a QNEC to be funded by plan forfeitures.
- Erroneously excluded employee problem and use of forfeitures



# Overpayment corrections (401k and other defined contribution plans)

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- The employer takes reasonable steps to have the Overpayment, adjusted for Earnings at the plan's earnings rate from the date of the distribution to the date of the repayment, returned by the participant or beneficiary to the plan.
- To the extent the amount of an Overpayment adjusted for earnings at the plan's earnings rate is not repaid to the plan, the employer or another person must contribute the difference to the plan.
- The employer does not have to contribute the difference, however, if "the failure arose solely because a payment was made from the plan to a participant or beneficiary in the absence of a distributable event (but was otherwise determined in accordance with the terms of the plan (e.g. an impermissible in-service distribution)."



# 401(k) Plans RP 2013-12 updates: SCP Eligibility and 415 failures

- A plan that provides for elective deferrals and nonelective employer contributions that are not matching contributions is not treated as failing to have established practices and procedures to prevent the occurrence of a § 415(c) violation if:
  - Excess annual additions under § 415(c) are corrected by return of elective deferrals to the affected employee
  - Correction is completed within two and one-half months after the end of the plan's limitation year.
  - The correction does not violate another applicable Code requirement.

Ref: section 4.04 of RP 2013-12



# Lost participants

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- IRS letter forwarding program is no longer available as a search method.
  - Specifies some methods that may be used to find lost participants (i.e. use of a non-IRS letter forwarding program, a commercial locator service, a credit reporting agency, or Internet search tools.)
  - A plan will not be considered to have failed to correct a failure due to the inability to locate an individual if reasonable actions to locate the individual have been undertaken in accordance with this section 6.02(5), provided that, if the individual is later located, the additional benefits are provided to the individual at that time.



# Common 401(k) plan failures

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- For common failures in 401(k) plans please see:
  - <http://www.irs.gov/Retirement-Plans/Plan-Sponsor/Fixing-Common-Plan-Mistakes>
- Common mistakes have been identified. Ideas presented on steps that can be taken to:
  - Find errors, fix them and avoid them going forward.
  - (FIND, FIX, AVOID)



## 401(k) plan failures contd..

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- Failure to timely update plan documents
- Failure to operate the plan in accordance with plan terms
  - Compensation
  - Matching contributions
  - ADP/ACP test
  - Eligible employees
  - 402(g) limit
  - Top Heavy contributions
  - Hardship distributions
  - Loans (incl. compliance with § 72(p))



# Finding plan document mistakes

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- Review of records including:
  - Original plan document
  - Subsequent amendments or restatements
  - Adoption Agreements
  - Opinion Letter or Advisory Letter issued by the IRS
  - Determination Letter issued by the IRS
  - Board of Directors' resolutions/minutes
  - Summary Plan Description



# Correcting plan document mistakes

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- Adoption of corrective amendments
- VCP submission
  - Appendix C Sch. 1 available for interim amendments (and extended RAP has not expired);
  - Appendix C Sch. 2 available for non-amenders (i.e. extended RAP for law changes has expired). DL application required if correction is made using individually designed plan.



# Avoiding plan document mistakes

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- Maintenance of plan document records
- Frequent interaction between employer and service provider
- Maintenance of a calendar that would provide deadlines by which certain amendments need to be adopted
- Consistency between plan and SPD



# Identifying/avoiding mistakes arising from plan operation

- Familiarity with the terms of the plan
  - Employer, Employees, Service providers
  - Communications between parties (e.g. Human Resources may need to communicate the definition of compensation used for determining elective deferrals to Payroll)
- Periodic review of plan operations and plan terms (review should also include review of systems, e.g. implementation of automatic enrollment, auto-escalation)
- Checklists
  - IRS checklist

<http://www.irs.gov/pub/irs-pdf/p4531.pdf>



# Correcting mistakes arising from failure to operate plan in accordance with terms of plan document

- See correction principles; App. A/B
- SCP may be available



# Selected correction issues

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- Compensation (plan document less and/or more inclusive than plan operation) *More inclusive than plan operation, difficulty with correction by plan amendment*
- Exclusion of eligible employees (and impact of auto-enrollment feature) *Failure to implement a negative election or improper exclusion e.g. failure to receive enrollment materials?*
- Failed ADP/ACP test (use of forfeitures for corrective QNEC). *Can't use forfeitures because of limitations of IT Reg. 1.401k-6*
- Safe Harbor 401(k) plans (Failure to provide safe harbor notice). *Impact- improper exclusion of employee or simple admin. failure*
- Hardship Distributions (Failure to suspend elective deferrals) *Return of improper deferrals, forfeit match; as well other alternatives*
- Loans (72(p) relief; loan start date; owners)



# Compensation

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- Wages and salaries
- Commissions
- Bonuses
- Etc.
- Typical problem:
  - Improper inclusion or exclusion of one or more categories of compensation for employer contributions or elective deferrals



## Example 1

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- Plan definition of comp. excludes bonuses for purposes of employer contributions and elective deferrals.
- Jane receives a \$30,000 bonus and contrary to plan terms:
  - receives additional 5% profit sharing contribution (\$1,500)
  - makes 6% elective deferral (\$1,800)



## Correction

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- Forfeit profit sharing allocations of \$1,500 plus earnings, place in an unallocated account to be used for profit sharing allocations
- Distribute improper elective deferral of \$1,800 plus earnings



## Example 2

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- Plan definition of comp. includes bonuses for purposes of employer contributions and elective deferrals.
- In operation, contrary to plan terms, bonuses were excluded. Bob elected to defer 5% of compensation. The profit sharing contribution for the year was 3% of compensation. Bob's bonus for the year was \$10,000.



# Correction

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- Deferrals: Bob was not provided with the opportunity to make deferrals from “bonus” compensation. If Bob’s election was properly implemented, an additional \$500 ( $5\% \times \$10,000$ ) would have been withheld for deferral. The missed deferral opportunity is  $50\% \times \$500$  or \$250. The employer should make a corrective QNEC of \$250 (adjusted for earnings) on behalf of Bob.
- Employer P/S contribution: By not counting bonuses, Bob’s profit sharing contribution was understated by \$300 ( $3\% \times \$10,000$ ). The employer should make a corrective contribution of \$300 (adjusted for earnings) on behalf of Bob.



# Exclusion of eligible employees (general rules for correction)

## General Rule:

- Elective deferrals: Employer makes a corrective contribution to replace the missed deferral opportunity for the period of exclusion. Missed deferral opportunity = 50% of the employee's missed deferral (estimated using ADP for the employee's category during year of exclusion).
- Matching contributions: Employer makes a corrective contribution equal to contributions employee would have received had the missed deferral been made.



# Exclusion of eligible employees (variations)

- Failure to implement employee elections
  - Use employee's elected deferral percentage instead of ADP
- Failure to implement an employee's election for all categories of compensation (e.g. bonuses)
  - May be able to calculate missed deferral using the employee's election in file.
- Failure to provide safe harbor notice in a safe harbor 401(k) plan
  - Could it result in an "excluded employee" problem?



# Excluded employees and automatic enrollment

Is the failure to implement a plan's automatic enrollment provision-

- (a) a failure to implement an employee's negative election? (e.g. failure occurred because employee took no affirmative action upon receiving election forms, but payroll did not withhold in accordance with the participant's "negative election")
- (b) an erroneous exclusion of an eligible employee? (e.g. failure occurred because employee did not receive enrollment materials and was not provided with the opportunity to make elective deferrals to the plan )



# Correction of failed ADP/ACP tests

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- Correction can be made within 12 months after the end of the plan year [IRC 401(k)(8), 401(m)(6)]
- If 12 months have elapsed since close of the plan year: EPCRS is available
- EPCRS corrections:
  - Uniform QNEC (App. A .03 of RP 2013-12)
  - 1 to 1 correction (App. B 2.01 of RP 2013-12)



# Use of forfeitures to make corrective QNECs

- Can a plan use forfeitures to make QNECs for correcting a failed ADP test?
  - No. See QNEC definition in IT Reg. 1.401(k)-6. It requires that the QNEC come from nonelective contributions that satisfy vesting (100%) and distribution requirements under 401(k) when contributed to the plan. Forfeitures are derived from contributions that were not fully vested when made.
- Will the Service permit the use of forfeitures to provide for the employer contribution in the case of:
  - Employees improperly excluded from making elective deferrals to the 401(k) plan? Yes, if employee is fully vested and the 401(k) distribution restrictions apply when the contribution is allocated.



# Safe harbor 401(k) plan- Failure to provide notice

- Correction depends on the impact on individual participants.
  - If failure to provide notice results in an employee not being able to make elective deferrals to the plan, then the failure to provide notice would result in the erroneous exclusion of an eligible employee. Corrective contributions on behalf of the employee would be required.
  - If employee otherwise informed and able to make elective deferrals, then correction may involve revising practices and procedures going forward.



## Failure to suspend deferrals

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401(k) plan provides that upon receiving a hardship distribution, the participant is prohibited from making elective deferrals for 6 months. In operation, plan fails to suspend deferrals. Correction?



# Failure to suspend deferrals contd..

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- Option 1- Can plan return the improper elective deferrals (adjusted for earnings) to employee? Yes. This would put the participant in the same position he or she would have been in had failure not occurred.
- Option 2- Can plan suspend elective deferrals for a six month period going forward? Possibly. However, this may not put the participant in the same position.
  - Matching contribution levels for the six month period going forward could be different than what they were during suspension period.
  - Participant may quit employment before expiration of 6 month period.



## Failure to suspend deferrals contd..

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- Option 3- Take no action. Revise administrative procedures going forward?
- No. The failure will not have been corrected.



# Participant Loans: 72(p) relief for owner participants?

- Appendix C schedule 5 is not available for VCP applications in cases where the affected participant is also the owner of the business. Does this mean 72(p) relief is not available for an owner?
  - No. But more facts are needed before a decision can be made. These could include answers to questions such as: Was the loan itself a bonafide loan? Or is it a withdrawal that is being recharacterized as a loan? Were there reasonable attempts to make payments on the loan? How long did the problem occur before attempts at correcting the missed payments were made? Why did the problem occur and what steps are being taken to ensure that the problem does not occur again?
- These details can be addressed in a VCP application using the format under Appendix C in Rev. Proc. 2013-12.



## Defaulted Loan- Employer payment

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Section 6.02(6) of Rev. Proc. 2013-12 states that if a loan is being corrected under EPCRS, the employer should pay the portion of the correction payment equal to the interest that accumulates as a result of the failure. When is employer payment required?



# Defaulted Loan- Employer payment contd..

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- Participant's responsibility to make payments on the loan- both principal and interest. However, employer payments could be required under certain circumstances
  - Failure occurred because of employer actions
  - Rate of return on plan investments exceeded plan loan rate.



# Defaulted Loan.. Reamortization correction

- If a defaulted loan is being corrected under EPCRS through reamortization, is it permissible to use an interest rate that is different from the interest rate used at the time the loan was made?
- Assuming the interest rate on the loan complied with plan terms at the time the loan was made, it is expected that the correction would be made using the interest rate on the loan.