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View From Groom: IRS Liberalizes IRS Correction Program for Qualified Plans

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The IRS recently expanded one of its most popular programs, the Employee Plans Compliance Resolution System (''EPCRS''), which provides qualified plan sponsors the tools to correct and maintain the tax-qualified status of their retirement plans.[1]

Revenue Procedure 2015-27 (60 PBD, 3/30/15) and Revenue Procedure 2015-28 (64 PBD, 4/3/15), released on March 27 and April 2, respectively, are intended to make it easier for plan sponsors to correct the most common qualified plan mistakes, including errors relating to loans, overpayments and employee elective deferrals, including automatic enrollment. The expansions can be relied upon immediately.[2]

The key changes and additions to EPCRS made by these Revenue Procedures are summarized below.

I. Revenue Procedure 2015-27

A. Reduced Fees for Certain Loan Failures. ***Prior Rule:*** Revenue Procedure 2013-12 provides for a 50% reduced Voluntary Compliance Program (''VCP'') compliance fee for failures to comply with the plan loan requirements under the Internal Revenue Code (the ''Code''), if (1) the VCP submission involves a loan error corrected in accordance with the prescribed correction methods, (2) the failure does not affect more than 25% of the plan sponsor's participants in any year in which

[1] EPCRS is currently set forth in Revenue Procedure 2013-12, 2013-4 I.R.B. 313.

[2] Revenue Procedure 2015-27 is generally effective July 1, 2015, but plan sponsors may, at their option, apply its provisions on or after March 27, 2015. Revenue Procedure 2015-28 is effective as of April 2, 2015.

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the failure occurred, and (3) the failure is the only failure described in the submission.[3]

Revised Rule: Under Revenue Procedure 2015-27, if the three requirements described above are satisfied, the compliance fee will be based on the number of participants affected and not the number of participants in the plan:

Number of Participants with Loan Failures	*Compliance Fee*
13 or fewer	$300
14 to 50	$600
51 to 100	$1,000
101 to 150	$2,000
Over 150	$3,000

No special relief is provided for group VCP submissions.

Observation: Plan loan failures may result from recordkeeping systems errors through no fault of the participant and can lead to harsh tax consequences. In general, unless a loan failure is corrected under VCP or Audit Closing Agreement Program ("Audit CAP"), the failure must be reported as a deemed distribution to the participant on Form 1099-R for the year in which the failure occurred.[4] This can have significant tax consequences for the participant, even if the loan failure was not due to the participant's error. Previously, to obtain reporting relief, a large employer with over 10,000 plan participants would be subject to a $12,500 VCP filing fee, even for only one loan failure. The reduced VCP fee of $300 to $3,000 (depending on the number of affected participants) is therefore a welcome change. Going forward, plan sponsors may be more willing to submit VCP filings for loan failures to obtain IRS reporting relief for affected participants.

B. Expansion of Reduced VCP Fee for Required Minimum Distribution Failures. ***Prior Rule:*** Revenue Procedure 2013-12 provides for a reduced VCP compliance fee of $500 for a failure to satisfy the Code's required minimum distribution ("RMD") requirements if there are 50 or fewer participants affected by the failure, provided that: (1) no other failures are included in the submission, and (2) the failure would result in the imposition of the 50% excise tax under Code section 4974 (imposed on the participant who should have received the RMD).[5] Under VCP or Audit CAP, the plan sponsor can request that the Code section 4974 excise tax be waived. Waiver of the excise tax is not available through self-correction, however.

Revised Rule: For RMD failures described above, the VCP fee is $500 if as many as 150 participants are affected, and $1,500 if 151 to 300 participants are affected. If more than 300 participants are affected, the regular VCP fee based on the total plan population will apply. This new rule is not applicable to group VCP submissions.

[3] Revenue Procedure 2013-12, § 12.02(3).

[4] Self-correction is not available for loans that do not comply with Code section 72(p)(2). Revenue Procedure 2013-12, § 6.07.

[5] Revenue Procedure 2013-12, § 12.02(2).

C. Plan Overpayments. ***Prior Rule:*** To correct an overpayment from a defined benefit plan, Revenue Procedure 2013-12 provides that the plan sponsor should take reasonable steps to have the overpayment, with appropriate interest, returned by the participant to the plan.[6] A similar requirement applies for correcting overpayments from defined contribution plans (including 403(b) plans).

Revised Rule: Revenue Procedure 2015-27 clarifies that for defined benefit and defined contribution (including 403(b) plan) overpayments, depending on the nature of the failure, it may be appropriate to have the employer or another person contribute the amount of the overpayment (with appropriate interest) to the plan instead of having the participant repay it to the plan. However, this method would presumably still require the employer to notify the affected participant that the overpayment was not eligible for a tax-free rollover. The Revenue Procedure also specifies that another appropriate correction method would be to adopt a retroactive amendment to conform the plan document to the plan's operations (although this correction method would only be available under VCP or Audit CAP, and would not be available if the failure is self-corrected). This change is in response to concerns that, in accordance with Rev. Proc. 2013-12 (and prior versions), plan sponsors have demanded recoupment of large amounts from plan participants and beneficiaries on account of benefit calculation errors made over lengthy periods of time, and that plan participants and beneficiaries (particularly older individuals) may have financial difficulties in making the repayment, with accumulated interest.

Possible Further Revisions: The IRS states that it intends to further revise EPCRS regarding correction of overpayments and is seeking comments on whether:

- make-whole contributions should be required to be made by the employer rather than being sought from participants and beneficiaries,
- guidance should be provided on overpayments due to benefit calculation errors and whether the correction methods should follow rules similar to PBGC rules for recoupment of overpayments (providing for an actuarial reduction of future benefit payments, without interest, generally capped at a 10% reduction in the participant's monthly benefit),
- further guidance is needed on the calculation of interest on benefit calculation errors, and
- there is a need for other overpayment changes or guidance (including guidance on any unusual circumstances in which full correction should not be required).

Comments on these issues should be submitted to the IRS by *July 20, 2015*.

Observation: EPCRS has historically been unclear on whether an employer could make a corrective payment to the plan without first seeking repayment from the participant, and still comply with the prescribed correction method. This clarification from the IRS – that repayment need not be sought from participants in all cases – provides additional flexibility to plan sponsors in correcting overpayments, both through VCP and through self-correction. This clarification is also consis-

[6] Revenue Procedure 2013-12, § 6.06(3), (4).

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tent with the general analysis under Title I of ERISA which allows a plan fiduciary to weigh all of the facts and circumstances, including the potential burdens on plan participants, the cost of correction, the likelihood of recovery, etc., in deciding whether to pursue recovery from participants and beneficiaries.

D. SCP Eligibility Extended for Repeated 415 Violations. ***Prior Rule:*** In general, to be eligible under the Self Correction Program (''SCP''), a plan sponsor must have established practices and procedures reasonably designed to promote and facilitate overall compliance with Code requirements. Under Revenue Procedure 2013-12, a plan that provides for elective deferrals and nonelective employer contributions will not fail to have these practices and procedures if it corrects Code section 415(c) violations (*i.e.*, excess annual additions) by returning elective deferrals to the affected participant within 2-1/2 months after the end of the plan's limitation year.[7] Thus, under this rule, even if a plan sponsor does not monitor the 415 limits during the year, the plan sponsor may still be eligible for self-correction under SCP. However, this rule is not available for plans with matching contributions – such plans must monitor the 415 limits during the limitation year to remain SCP-eligible.

Revised Rule: The new rule extends the 2-1/2 month correction period until 9-1/2 months after the end of the plan's limitation year. This gives more flexibility for plans that do not test for the 415 limits until after the end of the limitation year. Rather than having to distribute 415 excess annual additions by March 15 of the year following the limitation year for a calendar year plan, plan sponsors have until October 15 to distribute any excess annual additions.

E. New Forms for Model VCP Submission Documents. ***Prior Rule:*** Under Revenue Procedure 2013-12, a VCP applicant may use the Model Compliance Statement format in Appendix C of Part I of Revenue Procedure 2013-12 and the Schedules set forth in Part II. Currently, Schedules 1 through 9 provide streamlined submission formats for correcting common qualification failures using standardized correction methods. If an applicant wishes to obtain an acknowledgement letter, the plan sponsor must submit the Acknowledgement Form in Appendix D of Revenue Procedure 2013-12.

Revised Rule: Revenue Procedure 2015-27 deletes Appendix C (Model VCP Submission Documents) and Appendix D (Acknowledgement Letter) of Revenue Procedure 2013-12, which have been replaced with official IRS forms. Now, if an applicant chooses to use the Model VCP format, the applicant must submit the official IRS forms containing the model format: (1) Form 14568, *Appendix C Part I, Model VCP Submission Compliance Statement*, available here: http://www.irs.gov/pub/irs-pdf/f14568.pdf and, if applicable (2) Form(s) 14568-A through 14568-I, comprising the Schedules, available here: http://www.irs.gov/Retirement-Plans/Correcting-Plan-Errors--Fill-in-VCP-Submission-Documents. To receive an acknowledgment letter for a VCP filing, the plan sponsor must submit IRS Letter 5265, available here: http://www.irs.gov/pub/irs-tege/letter5265.pdf. We note that Form 8951 has not yet been updated to reflect the new VCP compliance fees for loan failures and RMDs.

[7] Revenue Procedure 2013-12, § 4.04.

F. Other Changes. Revenue Procedure 2015-27 makes other miscellaneous changes to EPCRS, including clarifying that the requirement to submit a determination letter application concurrently with a VCP submission does not apply to (1) certain amendments to prototype or volume submitter plans, or (2) terminated plans if more than 12 months have passed since distribution of substantially all of the plan's assets in connection with the plan termination. Where a determination letter application is required to be filed concurrently with a VCP application, the time for adopting certain corrective amendments has been extended to the later of (1) 150 days after the date of the compliance statement or (2) 91 days after a favorable determination letter is issued. In addition, Revenue Procedure 2015-27 deletes the reference to the Social Security letter forwarding program because it is no longer available to locate lost participants.

II. Revenue Procedure 2015-28

Revenue Procedure 2015-28 expands on (rather than replaces) existing preapproved correction methods for correcting missed deferrals. For 401(k) and 403(b) plans, this Revenue Procedure introduces three new correction methods.

These new rules are intended to address concerns that the high cost of correcting missed deferrals – generally requiring a 50% qualified non-elective contribution (''QNEC'') plus any missed employer contributions – deterred employers from implementing automatic contribution features, in light of the increased risk of error associated with these features (and, in particular, automatic escalation features).

A. Failure to Implement Election for Automatic Enrollment Plans. ***Prior Rule:*** Under Revenue Procedure 2013-12, a failure to implement a pre-tax deferral election (either a deemed election or an affirmative election) under a plan with an automatic contribution feature requires the plan sponsor to make a qualified non-elective contribution (''QNEC'') to the plan representing the employee's ''missed deferral opportunity.''[8] In general, for a failure to implement an election (either a deemed election or affirmative election), the missed deferral opportunity is 50% of the participant's elected deferral percentage multiplied by the participant's compensation, subject to applicable plan and Code limits, adjusted for earnings.[9] If the plan provides for matching contributions, the plan sponsor must also make an employer nonelective contribution equal to the missed match (if any) the employee would have received had the failure not occurred, adjusted for earnings through the date of the corrective contribution.[10]

New Rule: In addition to the rule noted above, under Revenue Procedure 2015-28, if the failure to implement

[8] Revenue Procedure 2013-12, Appendix A, § .05(5).

[9] For a failure to implement an election to make after-tax contributions, a 40% QNEC is generally required. Separate correction rules apply for determining the ''missed deferral opportunity'' for elective deferrals, catch-up, after-tax and Roth contributions where the employee was improperly excluded from participation for plans with no automatic contribution feature.

[10] Special correction rules apply for failures to implement elections under safe-harbor plans under Code section 401(k)(12) or 401(k)(13).

an automatic contribution feature or an affirmative election for an employee otherwise subject to an automatic contribution feature does not extend beyond the end of the 9-1/2 month period after the end of the plan year of the failure (October 15 for a calendar year plan), no QNEC for the missed deferral is required if the following requirements are satisfied:

Timely Commencement of Elective Deferrals: correct deferrals begin no later than the earlier of (i) the first paycheck made on or after the last day of the 9 1/2 month period after the end of the plan year in which the failure occurred, or (ii) if the plan sponsor was notified by the employee, the first paycheck made on or after the last day of the month after the month of notification.

45 Day Notice: notice of the failure is given to the affected employee no later than 45 days after the deferral commencement date (described above). The notice must contain:

- general information about the failure, such as the correct deferral percentage and the date the deferrals should have commenced (but disclosing a dollar amount is not required),
- a statement that appropriate amounts have begun to be deducted from compensation and contributed to the plan or will begin shortly,
- a statement that corrective contributions relating to the missed matching contributions have been made or will be made (but information on the date and amount of corrective contributions are not required),
- an explanation that the participant may increase his or her deferral percentage to make up for the missed deferral opportunity, subject to the Code section 402(g) limits, and
- the name of the plan and plan contact information (including the name, street address, email address and phone number of a plan contact).

Missed Matching Contributions: corrective contributions (adjusted for earnings, as described below) to make up for full missed matching contributions are made consistent with the SCP timing requirements for significant operational failures (*i.e.*, no later than the end of the second plan year following the plan year in which the missed matching contribution occurred).

Earnings: For purposes of this correction method (and for the two correction methods described below), if the employee has not made an investment election, missed earnings can be calculated based on the plan's default investment alternative. However, for this correction method, the total earnings amount, including cumulative losses, may not reduce the required corrective contributions relating to any matching contributions.[11]

Sunset: This safe harbor correction method for failures relating to automatic contribution features expires on December 31, 2020. The IRS may extend this date, depending on relevant factors, including whether there has been an increased number of plans with automatic enrollment.

B. Employee Elective Deferral Failures that do not Exceed Three Months. ***Prior Rule:*** If the affected employee has had the opportunity to make elective deferrals for at least the last nine months of the plan year, up to the maximum permitted amount, then no corrective contribution for the missed deferral opportunity is required. Corrective contributions for the missed matching contributions (plus earnings) for the first three months of the plan year would still be required.[12]

New Rule: Revenue Procedure 2015-28 adds a new safe harbor correction method to cover ''Employee Elective Deferral Failures'' corrected by the end of *any* three month period. The term ''Employee Elective Deferral Failure'' is broadly defined to include: (1) a failure to implement elective deferrals correctly in a 401(k) or 403(b) plan pursuant to an affirmative election or pursuant to an automatic contribution feature under a 401(k) or 403(b) plan and (2) a failure to provide an employee with the opportunity to make an affirmative election because the employee was improperly excluded from the plan. Automatic contribution features include automatic enrollment and automatic escalation features, including an automatic escalation feature that is affirmatively elected. Under this new safe harbor, no QNEC for the missed deferral is required if the following requirements are satisfied:

Timely Commencement of Elective Deferrals: correct deferrals must begin no later than the earlier of (i) the first paycheck made on or after the three-month period that begins when the failure first occurred for the employee, or (ii) if the plan sponsor was notified by the employee, the first paycheck made on or after the last day of the month after the month of notification;

45 Day Notice: notice of the failure is given to the affected employee no later than 45 days after the date on which correct deferrals begin. The notice must contain:

- general information about the failure, such as the correct deferral percentage and the date the deferrals should have commenced (but disclosing a dollar amount is not required),
- a statement that appropriate amounts have begun to be deducted from compensation and contributed to the plan or will begin shortly,
- a statement that corrective contributions have been made or will be made (but information on the date and amount of corrective contributions are not required),
- an explanation that the participant may increase his or her deferral percentage to make up for the missed deferral opportunity, subject to the Code section 402(g) limits, and
- the name of the plan and plan contact information (including the name, street address, email address and phone number of a plan contact).

Missed Matching Contributions: corrective contributions to make up for missed matching contributions (if any), adjusted for earnings as described below, are made consistent with the SCP timing requirements for significant operational failures (*i.e.*, no later than the end of the second plan year following the plan year in which the missed matching contribution occurred).

Earnings: Where the participant has not made an investment election, earnings can be calculated based on

[11] The plan sponsor may also use the earnings adjustment methods described in Appendix B, § 3.

[12] Revenue Procedure 2013-12, Appendix B, § .02(1)(a)(ii)(F).

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the plan's default investment alternative.[13] Presumably, the restriction on cumulative losses applies only to the correction method described in Part II.A above and does not apply under this correction method or the correction method described below.[14]

C. Employee Elective Deferral Failures that Do Not Extend Beyond the SCP Correction Period for Significant Failures. ***Prior Rule:*** Revenue Procedure 2013-12 did not contain a special rule for corrections of missed deferrals within two years following the error. The general correction rules for missed deferrals apply (these are briefly summarized above).

New Rule: In addition to the existing correction methods, for corrections that extend beyond the original three-month period (or the conditions for the other two new safe harbors are not satisfied), the plan sponsor can correct an Employee Elective Deferral Failure (as defined above) by making a corrective contribution equal to 25% of the missed deferrals (25% QNEC), if the following requirements are satisfied:

Timely Commencement of Elective Deferrals: correct deferrals must begin no later than the earlier of (i) the first paycheck made on or after the last day of the second plan year following the plan year when the failure first occurred, or (ii) if the plan sponsor was notified by the employee, the first paycheck made on or after the last day of the month after the month of notification;

45 Day Notice: notice of the failure (containing the disclosure described in Part II.B above) is given to the affected employee no later than 45 days after the date on which correct deferrals begin, and

Corrective Contributions: corrective contributions (including the 25% QNEC and those relating to any missed matching contributions), adjusted for earnings as described below, are made consistent with the SCP timing requirements for significant operational failures.

Earnings: Where the participant has not made an investment election, earnings can be calculated based on the plan's default investment alternative.[15]

III. Conclusion

These changes to EPCRS reflect that the IRS recognizes the need to liberalize EPCRS areas that frequently plague plan sponsors. We hope that the IRS continues to seek input from the community in further improving and expanding EPCRS, including the self-correction program, which reduces burdens on the IRS as well as plan sponsors.

Plan sponsors and their advisors should review this new guidance carefully, particularly the three new correction methods for elective deferral failures described in Revenue Procedure 2015-28. While these new preapproved methods should reduce correction costs, they impose additional conditions on correction. And they are only available for errors that are caught and corrected within a specified period of time. It is therefore essential that plan sponsors incorporate periodic reviews of plan operations to ensure they can take full advantage of these new rules.

Notably, as the guidance is effective immediately, failures relating to missed deferrals that have recently been discovered may be eligible for correction under the new rules. If one of the new correction methods is used, plan sponsors should keep in mind the 45-day deadline for notifying the affected participants of the correction.

[13] Revenue Procedure 2013-12, Appendix A, § .05(9)(a)(iii), as revised by Revenue Procedure 2015-28.

[14] Revenue Procedure 2015-28, § 3.02(2).

[15] Revenue Procedure 2013-12, Appendix A, § .05(9)(b)(iii), as revised by Revenue Procedure 2015-28.