

JOURNAL *of* PENSION BENEFITS

ISSUES IN ADMINISTRATION, DESIGN, FUNDING, AND COMPLIANCE
Volume 32 • Number 3 • Spring 2025

LEGAL DEVELOPMENTS

IRS Issues Interim Guidance on “Inadvertent Benefit Overpayments”

This column provides a summary of the interim guidance provided by Notice 2024-77 for inadvertent benefit overpayments.

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Section 301(b) of Division T of the Consolidated Appropriations Act, 2023 [Pub. L. 117-328, 136 Stat. 4459 (2022) (SECURE 2.0 Act)]

provided important correction relief for certain qualified plan overpayments. In short, the relief generally permits a qualified plan to allow participants to retain inadvertent benefit overpayments without the employer needing to make a corrective payment to the plan (or adopt a plan amendment). Moreover, certain overpayments are treated as eligible rollover distributions, so that amounts placed in an individual retirement account (IRA) or another qualified plan can remain there. Notice 2024-77 provides, in question-and-answer format, important clarifications regarding the scope of this relief, and the impact on existing Revenue Procedure 2021-30 (EPCRS), which has a number of safe harbor provisions for correcting defined contribution and defined benefit overpayments. A summary of the interim guidance is set forth below.

Types of Plans Covered

Eligible plans include:

- (i) a plan described in Internal Revenue Code (Code) Section 401(a) which includes a trust exempt from tax under Section 501(a);
- (ii) an annuity plan described in Section 403(a);
- (iii) a plan established for its employees by the United States, by a State or political subdivision thereof or any agency or instrumentality of any of the foregoing; and
- (iv) an annuity contract described in Section 403(b).

What Is Not Covered

This Notice does not provide any guidance regarding Section 301(a) of SECURE 2.0 concerning the relief under the Employee Retirement Income Security Act of 1974 (ERISA) for inadvertent benefit overpayments. Moreover, this Notice does not impact the plan sponsor's obligation to make contributions to a plan to meet the minimum funding standards under Code Sections 412 and 430 or to prevent or restore an impermissible forfeiture in accordance with Code Section 411. Moreover, the plan sponsor must still observe any limitations imposed on it by Code Sections 401(a)(17) and 415, and the plan may enforce these limitations using any method approved by the Secretary of Treasury for recouping benefits previously paid or allocations previously made in excess of the limitations.

Notably, nothing in SECURE 2.0 Section 301 relieves a fiduciary from responsibility for an overpayment that resulted from a breach of its fiduciary duties.

Inadvertent Benefit Overpayment—Defined

An “inadvertent benefit overpayment” is an eligible inadvertent failure, as defined in Section 305(e) of SECURE 2.0, that occurs due to a payment made from an eligible plan that exceeded the amount payable under the terms of the plan or a limitation provided in the Code or regulations.

An “eligible inadvertent failure” is broadly defined in Section 305(e) of SECURE 2.0 as a failure that:

- 1. Occurs despite the existence of established practices and procedures that, as relevant to employer sponsored plans, satisfy the standards set forth in Section 4.04 of EPCRS;
- 2. Is not egregious;
- 3. Does not relate to the diversion or misuse of plan assets; and

- 4. Is not directly or indirectly related to an abusive tax avoidance transaction.

[See Notice 2023-43]

An inadvertent benefit overpayment also includes a payment made before a distribution is permitted under the Code or under the terms of the plan. However, an inadvertent benefit overpayment does not include: (i) a payment made to a disqualified person, as defined in Code Section 4975(e)(2) or owner-employee as defined in Section 401(c); or (ii) a payment that is made pursuant to a correction method provided under EPCRS for a different qualification failure. Notably, this exclusion for overpayments related to owner-employees and disqualified persons was not set forth in the statute or the legislative history.

Impact on EPCRS

Except for special rules for Code Sections 415 and 401(a)(17), and for Code Section 436 funding violations, any requirement described in Section 6.06 of EPCRS (including Sections 2.04 to 2.05 of Appendix B) that a corrective payment be made to a plan with respect to an inadvertent benefit overpayment no longer applies. This relief, however, does not extend to other failures that may occur as the result of an inadvertent benefit overpayment. For example, if a plan participant received an inadvertent benefit overpayment due to an incorrect allocation of a profit-sharing contribution under a plan, another plan participant may have received a benefit underpayment. In this case, the benefit underpayment would be considered an additional failure in need of correction, which may still require a corrective payment. Similarly, an employer may be required to make a corrective payment to prevent or restore an impermissible forfeiture in accordance with Code Section 411.

Importantly, this new relief does not prohibit a plan sponsor from seeking recoupment of inadvertent benefit overpayments from overpayment recipients. Specifically, the relief does not change the rule in Section 6.06 of EPCRS that recoupment from overpayment recipients is permitted but not required. For example, a plan sponsor may continue to use the overpayment correction methods under EPCRS (subject to the new ERISA requirements under Section 301(a) of SECURE 2.0, which, in part, impose conditions on recoupment of an inadvertent benefit overpayment from a participant or beneficiary).

Lastly, the following provisions of EPCRS are modified or are no longer applicable with respect to an inadvertent benefit overpayment:

- *Definition of Overpayment.* The definition of an overpayment in Sections 5.01(3)(c) and 5.02(4) of EPCRS is modified by this notice for an overpayment that is an inadvertent benefit overpayment.
- *Eligible Rollover Distribution.* Any requirement in Sections 6.06(3)(b)(ii) and (4)(b)(ii) of EPCRS that a plan sponsor must notify an individual that an overpayment is not an eligible rollover distribution no longer applies to the portion of an inadvertent benefit overpayment not sought for recoupment (other than as described below with respect to the portion of an inadvertent benefit overpayment for which recoupment is sought but is not returned to the originating plan).
- *Corrective Payment.* Any requirement of a corrective payment in Section 6.06 of EPCRS no longer applies to an inadvertent benefit overpayment (other than as described below for Sections 436, 401(a)(17) or 415 failures).
- *Excise Tax Relief.* Section 6.09(5) of EPCRS, which provides relief from the excise tax under Code Section 4973, is no longer necessary (and no longer applies) for any inadvertent benefit overpayment that is treated as an eligible rollover distribution.
- *Additional Income Tax.* Section 6.09(6) of EPCRS, which provides relief from the 10 percent additional income tax under Section 72(t), is no longer necessary (and no longer applies) for any inadvertent benefit overpayment that is treated as an eligible rollover distribution.

Eligible Rollover Treatment

Historically, an overpayment is not treated as an eligible rollover distribution. However, under the new relief the portion of a rolled-over inadvertent benefit overpayment (other than a Section 415/401(a)(17) failure) for which *recoupment is not sought* is treated as an eligible rollover distribution if the payment would have been an eligible rollover distribution but for being an overpayment. Accordingly, subject to the exception described in Q&A-6 of the Notice:

- If an inadvertent benefit payment is rolled over from an originating plan to a second plan and recoupment of all or a portion of the inadvertent benefit *payment is sought*, then the amount that is

sought and transferred back to the originating plan is treated both as an eligible rollover distribution from the originating plan and as an eligible rollover distribution transferred back to the originating plan.

- The portion of an inadvertent benefit overpayment for which recoupment is *sought that is not returned* to the originating plan is not treated as an eligible rollover distribution. Following EPCRS, the plan sponsor must notify the individual that any unreturned portion of the inadvertent benefit overpayment is not eligible for favorable tax treatment accorded to distributions from an eligible retirement plan (and, specifically, is not eligible for tax-free rollover). The notice provided to the participant regarding tax treatment of the unreturned portion of the overpayment may be combined with a plan sponsor's recoupment request.

Code Section 436 Failure (Funding Failure for Defined Benefit Plan)

With respect to a Code Section 436 failure under a plan that occurs as a result of an inadvertent benefit overpayment to an individual, to the extent the inadvertent benefit overpayment is not recouped on behalf of the plan from the individual, the plan sponsor or another person must make a corrective payment under the same circumstances as apply generally under EPCRS for an overpayment that is not an inadvertent benefit overpayment.

In addition, the overpayment rules discussed above relating to rollovers (and the impact of the plan seeking or not seeking recoupment on such rules) also apply to Section 436 failures.

Note that an amendment to increase past benefits that results in a Section 436 failure for a past year is permitted only if contributions are made in accordance with Code Section 436(c)(2) and Section 6.02(4) of EPCRS.

Code Section 401(a)(17) or 415 Failures

With respect to a Code Section 401(a)(17) or 415 failure under a plan that occurs as a result of an inadvertent benefit overpayment to an individual, to the extent the inadvertent benefit overpayment is not recouped on behalf of the plan from the individual, the plan sponsor or another person must make a corrective payment under the same circumstances as apply under EPCRS for an overpayment that is not an inadvertent benefit overpayment. As described above, the portion of an inadvertent benefit overpayment

for which recoupment is sought that is not returned to the originating plan is not treated as an eligible rollover distribution. The plan sponsor must notify the individual that any portion of the inadvertent benefit overpayment not returned to the plan is not eligible for favorable tax treatment accorded to distributions from an eligible retirement plan (and, specifically, is not eligible for tax-free rollover). The notice provided to the participant regarding tax treatment of the unreturned portion of the overpayment may be combined with a recoupment request.

Note that an amendment to increase past benefit payments in a manner that results in a violation of Sections 401(a)(17) or 415 for a past year is not permitted.

Effective Date

The amendments made by Section 301 of SECURE 2.0 are effective as of the date of enactment of the SECURE 2.0 Act, that is, December 29, 2022. Plans, fiduciaries, employers, and plan sponsors are entitled to rely on (1) a reasonable good faith interpretation of then existing administrative guidance for inadvertent benefit overpayment recoupments and recoveries that commenced before December 29, 2022; and (2) determinations made before December 29, 2022, by the

responsible plan fiduciary, in the exercise of its fiduciary discretion, not to seek recoupment or recovery of all or part of an inadvertent benefit overpayment.

In the case of a benefit overpayment that occurred before December 29, 2022, any installment payments made by the participant or beneficiary to the plan or any reduction in periodic benefit payments to the participant or beneficiary that were made in recoupment of such overpayment, and that commenced before December 29, 2022, may continue after that date.

This Notice applies as of the date it was issued—October 15, 2024. Prior to such date, a taxpayer may rely on a good faith, reasonable interpretation of Section 301(b) of SECURE 2.0 (which, if the Notice is followed, is deemed good faith). Note that the rollover relief applies as of December 29, 2022, regardless of when an inadvertent benefit overpayment was made.

Next Steps

Comments are welcome on this guidance, and additional guidance will be issued in the form of proposed regulations (and updated EPCRS). Plan sponsors should review their overpayment and rollover procedures to reflect the new relief.

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