

Q&A FROM CORRECTING ELECTIVE DEFERRAL FAILURES
Tues, April 24, 2018 and Wed, April 25, 2018

1. 2017 Auto Enrollment contribution corrected after 9½ months; 2018 improper exclusion corrected after 4 months of 2018 (April). Is the 2017 deferral subject to 25% QNEC and no QNEC for 2018?

If I am understanding the question correctly, you have two deferral failures in a plan with automatic enrollment. The first error was occurred in 2017. Since the time period for safe harbor method of correction for automatic enrollment plans is 9½ months after the close year, the employer will not need to make a corrective contribution for the deferral failure. With respect to the 2018 failure, the employer also will not need to make a corrective contribution because it was corrected timely.

2. Any application possibilities here for general implementation errors? For example, someone elects to defer 5% but it is entered into the payroll system as 3%?

The error you describe is a partial failure to implement and I would correct using the principles applicable to a failure to implement. In other words, I would determine the missed deferral and the correction would be determined on the basis of when it was corrected. For example, if it were corrected within three months of the failure, you could take advantage of the brief exclusion rule. If it were corrected more than three months following the date of the error but not later than the second year following the error, the plan could correct the deferral by making a QNEC equal to 25% of the missed deferral (plus earnings). The plan would also need to correct by making a contribution for any matching contributions.

3. Applying a SH missed matching contribution as a QNEC instead of a QMAC is wrong? Is there a testing or other situation where the QNEC would be treated differently than the QMAC?

You are correct. EPCRS refers to the corrective contribution for a safe harbor match as a QNEC. Substantively a QNEC and QMAC are virtually identical in that they are both 100% vested and subject to the same 401(k) distribution restrictions.

4. Are lost earnings calculated on the full deferral that was missed or are they calculated on the reduced amount that needs to be deposited as a QNEC?

Earnings are calculated on the corrective contribution amount (i.e., missed deferral opportunity) and not on the missed deferral.

5. Can a corrective match contribution be made as a traditional safe harbor match or does it have to be made as a "Qualified" QMAC?

When I refer to a safe harbor match I am referring to an ADP safe harbor match and such a match needs to be 100% vested. If the plan also provides for an ACP safe harbor match, such a matching can be subject to a vesting schedule. If the plan has an ACP safe harbor match subject to a vesting schedule, the corrective contribution for that match can be subject to a vesting schedule.

6. Can a deferral failure be corrected using the Safe Harbor Correction method (25% QNEC) if the time period has exceeded the 2 yr correction period, but the missed deferral is "insignificant"? IF yes, what is considered "insignificant"?

No. If the correction is beyond the second plan year following the plan year of the failure, the plan would need to correct using the general rule (50%). The factor of insignificance allows the employer to correct under SCP rather than filing under VCP.

7. Can forfeitures be used for the corrective contribution for the missed deferral and match if applicable? Earnings would not be payable from forfeitures though?

Great question. EPCRS provides that if the plan permits the use of forfeitures to reduce employer contributions, the plan may use them to make corrective contributions. EPCRS goes on to indicate that forfeitures used in making QNECs must satisfy the regulations. In January, 2017, the IRS issued proposed regulations that now permit a plan to use forfeitures to make QNEC and QMAC contribution. Accordingly, a plan that permits the use of forfeitures to reduce employer contributions should now be able to use forfeitures in making a corrective QNEC contribution. There is nothing in EPCRS that prevents an employer from using forfeitures for a corrective contribution for earnings.

8. Can we use the DOL Calculator for the earnings adjustment? It is difficult to obtain rates of return from Recordkeepers.

If it is not feasible to make a reasonable estimate of what the actual investment results would have been, a reasonable interest rate may be used. For this purpose, the interest rate used by the DOL's online calculator is deemed to be reasonable.

9. Can you give an example for a bonus payroll in which the ER didn't implement EE deferral elections for any ppts, but did implement elections on the regular payrolls before & after the bonus (not a SH plan). The error is discovered >3 months later. Notice?

A failure to implement with respect to a bonus is a partial failure to implement. In general, the employer should be able to use the same correction methods as it uses for a failure to implement. Because a bonus is generally a one time payment and the employee may not have the opportunity to increase deferrals for the balance of the year to make-up for the missed deferrals, the brief exclusion rule may not be available. However, the other safe harbor rules should be available. If the error was caught after three months, the employer could make a corrective QNEC contribution of 25% of the missed deferral. Since this is a safe harbor correction method, a notice is required.

10. Can you give an explanation of a missed opportunity that would be close to 2 years? How could a missed opportunity extend that long?

I agree that an error that extends for a two year period is unlikely. However, the two year period to which the safe harbor rule is referring is the length of time before the error is corrected. In other words, if the failure occurred in 2016, the error would need to be corrected by the end of 2018 to be within the time period of the safe harbor rule.

11. Can you have separate timing to determine how to correct (0.00%, 25% or 50%) for different employees that have been excluded or not having deferral election change implemented at different times during a plan year?

Yes. Depending on the failure, some participants may be under the brief exclusion rule while others may be under the other safe harbor or even the general rule.

12. Can you use actual compensation earned from 1/1/2017 to 7/1/2017 instead of dividing \$50,000 in half?

You may use actual compensation earned during the period of the failure, or, you may estimate the compensation for the period of the failure.

13. Can you use the DOL online calculator for calculating earnings for missed deferrals and late match? What is your experience with the IRS with this?

In certain circumstances. See the answer to question 8.

14. Do the corrective QNEC contributions and earnings need to be put into a separate source from deferrals and match or Safe Harbor Match?

EPCRS does not discuss sources. However, the plan would have to account for the QNEC separately from the deferrals and match because it is subject to different distribution rules.

15. Even though the QACA plan is a SH plan, my understanding is that the corrective allocation for the missed match does not need to be a QMAC, but it must be made to the QACA match source and subject to the vesting schedule. Is that correct?

You are correct. The QACA match can be subject to a two-year vesting schedule so the corrective contribution for such a match can be subject to the same vesting schedule.

16. Failure to implement an election- how long is administratively reasonable between receiving the election and implementing it?

Generally, that should either be set out in the plan document or some form of administrative policy. If it is not set out in the document or a policy, the IRS would apply some reasonableness standard.

17. For the amount of missed deferral, if found during a plan year, how is the Average ADP% determined?

You would need to make some form of reasonable estimation of the average ADP% for the employees.

18. From what I've read under the fix it guide there is a special rule for a terminated participant under the SH method?

The 401(k) fix it guide indicates that the safe harbor method of correction is not available to a terminated participant. However, EPCRS does not apply a limitation. My recommendation is to follow EPCRS.

19. How do these rules apply for an eligible form of compensation that did not have elective deferrals taken from?

You should be able to apply the same correction principles to the form of compensation from which the employer failed to implement a deferral election.

20. How do you self correct where a participant's bonus deferral election is not applied by the employer to the bonus? Which QNEC applies - 50% or 25%?

See the response to question 9.

21. How does a plan being SH Nonelective plan affect the missed deferral opportunity calculation?

The safe harbor nonelective contribution would not affect the missed deferral opportunity.

22. If a plan allows an employee to defer 100% of pay (less required FICA), would the non-safe harbor correction ever be available since it would be impossible to defer 100% unless they start at the beginning of the year?

Unfortunately, I am not following the question. Please feel free to give me a call regarding the question.

23. If a plan has a plan year computation period for match, should these missed deferral contributions be included in the year-end true-up calculations.

Yes.

24. If I have a missed deferral due to failure to implement a change and too much deferred due to a mistake in covered compensation can the two be netted before determining the missed deferral opportunity? and the error isn't discovered until AFTER the plan year ends.

Yes. I think you should be able to offset the correction by the "extra" deferrals.

25. If incorrect compensation was used for an affirmative deferral election in an automatic enrollment plan, can the safe harbor correction method be used (for automatic enrollment plans) for reasons of failure to correctly implement a deferral election?

I think that would be an aggressive position. I would correct by making a corrective QNEC contribution for the missed deferral opportunity.

26. If the match is due the end of the following year but is made prior to that deadline do earnings still need to be applied?

Although legally an employer has 12 months after the close of the year to make the safe harbor employer contribution, the employer must place the participant in the same position he/she would have been if the error had not occurred. Accordingly, the employer would calculate the earnings from the date the employer normally makes the contribution.

27. In the first example, if Dan elected 0% deferrals on 7/1/17, would you still do the correction?

Yes. In an improper exclusion, you don't know what he would have elected at an earlier date.

28. Is QDIA earnings rate for earnings restoration only applicable for auto enroll?

An employer may use the QDIA rate for any of the safe harbor correction methods. For other correction methods, the employer could consider the QDIA rate as a method for calculating earnings.

29. is the ADP% for improper exclusion determined after year-end? or year to date?

Year to date if you catch the error during the plan year.

30. Is the calculator on the DOL website an optional way to calculate earnings on these corrections? Or is that only to be used for late deposit of deferrals?

See the response to question 8.

31. Is there any guidance on whether the safe harbor rules (for reduced/no QNEC) can be applied for a participant who has since terminated employment?

See the response to question 18.

32. Match is made each payroll period, based on your presentation, income is not due for missed deferrals since the employer has until 12 months following the close of plan year? Does it matter if traditional or Safe Harbor Match?

If you have a periodic match, the earnings for a failure need to be calculated from the earlier of the last day of the quarter following the plan year quarter they were earned, or, the date the employer made the matching contributions for the other employees.

33. May an employer submit the correction through payroll to adjust W-2 if the missed opportunity was only for one missed payroll? Minimal impact...

If the employer missed one payroll period, the brief exclusion rule should protect the employer from needing to make a corrective contribution. Nevertheless, the employee has the right to increase subsequent deferrals to make-up for the missed deferrals.

34. Not clear on when you can use the Safe Harbor Brief Exclusion Rule? Does the plan have to be a Safe Harbor plan?

The safe harbor correction methods, including the safe harbor brief exclusion rule, apply both to safe harbor and traditional 401(k) plans.

35. So the match goes into the match source type for the plan, correct? Then subject to any vesting per terms of the plan.

You are correct.

36. Under what circumstances would these errors fall outside of SCP and need a VCP submission? Longer than two years and affecting a lot of employees? Repeated failures?

If the failures are significant and they are not corrected within the two year period, the employer should use VCP to correct the failures.

37. We see many employees allowed in too early. Hope you will cover that also.

To correct such a failure, the employer would return the deferrals to the employee. Alternatively, if the employees allowed in early are predominantly NHCEs, the employer can amend retroactively to conform the plan to its operation (change the eligibility provision for those employees).

38. What about employees who entered too early. Reasonable correction in operation? Other than 411g amendment...

See the answer to the previous question.

39. What happens with the missed deferral if the QNEC will trip over the plan or 402(g) limit?

Corrective contributions are subject to plan and statutory limits.

40. What if a company has multiple new hires and only 1 participant is allowed to defer in error BEFORE they are eligible. and the error isn't discovered until AFTER the plan year ends.

Either return the deferrals to the employee, or, if the employee is NHCE, adopt a conforming amendment.

41. What if a participant has made a deferral election but, in 2017, the participant receives a bonus where deferrals were not withheld. It was discovered in 2018. Would the client still be able to provide a notice and pay the missed opp of 25%? Or have they missed their 45 day notice window and have to pay 50% QNEC?

Yes. The time period for the safe harbor correction method is the second plan year after the year of the failure.

42. What if an ACA plan set up the employee on the correct effective date (7/1/17) however the EE had elected a higher amount that the ER missed. EE comes to ER in March 2018 to see why the proper amt isn't being deducted. ACA is 1%; EE wanted 5%; ER has SH Mt of 100% to 5%

If an employee made an affirmative election and the employer failed to implement, the correction fall under the failure to implement. The employer would need to correct by making a corrective contribution of 25% of the missed deferral.

43. What if the correction is made mid-year and the ADP test is not done yet. Can you use the last ADP test (ie 12/31/17)? Or do you have to wait until the end of 12/31/18 to calculate the missed opp?

You use the current year ADP% even if it is a prior year tested plan. If you catch the error mid-year, the employer would need to make a reasonable estimate of the ADP%.

44. What if the failure to implement, is a REDUCED election? Say, change from 6% to 3%

The employer would correct by returning the deferrals withheld in error.

45. What if there is a short plan year, or the plan adds deferral provisions during the year, resulting in less than 9 months?

Use the safe harbor brief exclusion rule that has a rolling three month correction period.

46. What is the correction for failure to implement a bonus election? For example, ppt is properly enrolled into the plan at 5%. Bonus only payment is made 4/1 and does NOT include the 5% deferral. Come the next regular payroll, 5% is properly deferred.

See the answer to question 9.

47. What is the correction procedure when a participant elected pre-tax deferrals and then changes to ROTH deferrals and the change is not implemented by the plan sponsor?

The employer would need to change the deferrals to Roth and amend the W-2.

48. What is the proper correction when a participant is not making ongoing deferral contributions but has elected to contribute \$18,000 from his year-end bonus and the company fails to implement his election? The error is not discovered until the following year.

I would recommend making a corrective QNEC contribution of 25% of the missed deferral.

49. When applicable, the average ADP % would be from the most recent completed ADP test? Or is it calculated for each affected pay period?

You use current year average ADP%. If you catch the error mid-year, you would need to make a reasonable estimate.

50. When determining the ADP%, if the participant is in the OEE group, do you use that ADP% instead of the ADP for the non-excludable participants?

You may not use the OEE in calculating corrective contributions.

51. Is the missed match in a non-safe harbor plan reported as match, QNEC, QMAC or nonelective contribution? match/non-elective contribution would be subject to vesting.

If the missed matching contribution is subject to a vesting schedule, the corrective contribution is an employer nonelective contribution and it would be subject to the plan's vesting schedule. However, if the missed match were an ADP safe harbor match (100% vested), the corrective contribution would need to be a QNEC.

52. Traditional 401k and person is missed for deferrals. If the match for everyone is calculated on annual basis at end of year do you wait to calculate his contribution and then no earnings are due?

In your fact pattern, I would wait until after the close of the year to calculate and make the match.

53. May Plan use Safe Harbor correction methods even if the participant has terminated in the meantime and does not have opportunity to "make up" his deferrals during the year. What if Plan allows for monthly entry dates and participant DOE was 12/1?

The 401(k) fix it guide indicates that the safe harbor method is not available for a terminated participant. However, EPCRS does not have such a restriction.

54. What about the failure to auto-escalate.? Does that also give rise to a QNEC?

Yes. You would need to correct by making a corrective QNEC.