



The Newest EPCRS Rules: IRS Notice Procedure 2023-43



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Your Presenters Today



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Agenda

- Self-Correction Under SECURE 2.0
- Eligible Inadvertent Failures
- Unanswered Questions
- In Comes Notice 2023-43
- Corrections Specifically Ineligible for SCP
- Unanswered Questions on the Notice



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Self-Correction Under SECURE 2.0

- Section 305 of SECURE 2.0 provides:
 - “Any eligible inadvertent failure ... may be self-corrected under [EPCRS]”
 - Exceptions:
 - Failure was identified by IRS before any action that demonstrates a specific commitment to implement the self-correction; or
 - Self-correction is not completed within a reasonable period after such failure is identified.
 - Directs the IRS to issue a new EPCRS procedure within 2 years



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Self-Correction Under SECURE 2.0

- Section 305 specifically notes that loan failures may be self-corrected
 - Self-corrected loans avoid deemed distribution treatment
- The DOL is directed to treat any self-correction under these rules to meet the requirements of VFCP (in other words, corrected loans are not prohibited transactions)
 - But, the DOL can require reporting or other procedures



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Self-Correction Under SECURE 2.0

- The IRS is instructed to amend EPCRS to allow self-correction of IRA issues by IRA custodians
 - Including allowing automatic waiver of RMD penalties from IRAs
 - Not effective until IRS issues new Revenue Procedure



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Eligible Inadvertent Failure (EIF)

- Defined by the law to be:
 - A failure that occurs
 - Despite the existence of practices and procedures
 - That satisfies the standards of Section 4.04 of Rev. Proc. 2021-30 (which requires that the established practices and procedures be “reasonably designed to promote and facilitate overall compliance in form and operation with applicable Code requirements”)



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Eligible Inadvertent Failure (EIF)

- Does not include:
 - Egregious failures – EPCRS examples:
 - Plan that consistently and improperly covers only HCEs
 - Plan that provides more favorable benefits to owners based on purported collective bargaining agreement
 - DC plan where contributions for HCE are several times greater than \$415 limit
 - Diversion or misuse of plan assets; or
 - Failures related to an abusive tax avoidance transaction



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Initial Things to Note

- EPCRS limits self-correction to operational failures (i.e., failure to follow the plan's terms) and certain limited document failures
 - SECURE 2.0 says "any EIF" – including demographic failures, previously unlisted document failures, and employer eligibility failures
- EPCRS limited self-correction of significant operational failures to a 3-year correction period
 - SECURE 2.0 says it can be corrected any time before the IRS identifies the failure



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WOW! REALLY???

(Yes, Really!)



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Unanswered Questions in the Law

- What constitutes a “specific commitment to correction”?
- What does “identified by the IRS mean”?
- What does a “reasonable period after identification” mean?
- Does this apply to failures that occurred pre-SECURE 2.0?
- Is VCP obsolete?



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Unanswered Questions in the Law



- How are demographic failures self-corrected?
- Can all document failures be self-corrected?
- Can any operational failure be self-corrected by adopting a retroactive amendment to conform the plan to actual operations?
- What about limits on self-correction in the current EPCRS procedure? Do they still apply?
- Will the IRS (as authorized in SECURE 2.0) require certain correction methods?
- What else don't we know?



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Enter Notice 2023-43

- IRS issued Notice 2023-43 to answer many of these questions while the new EPCRS procedure is being drafted
- Note: The Notice becomes obsolete when the new procedure is issued
 - Nothing requires the IRS to take the same positions in the final guidance that it is taking in the Notice



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What Does Notice 2023-43 Say?



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Effective Date for New SCP Rules

- Notice 2023-43 provides that the new procedures can be used to correct any eligible EIF in a qualified plan, 403(b) plan, SEP, or SIMPLE, even if it occurred before SECURE 2.0 became law
 - Corrections in process should be reevaluated to see whether anything has changed
 - Should VCP filings due to timing issues that are still awaiting IRS attention be revoked?
 - May not be able to recoup the user fee ...



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Specifically Ineligible for SCP

- Notice 2023-43 specifically excludes certain failures from self-correction
- Question: is that list exclusive?
 - It would seem that, other than the failures discussed above (i.e., egregious, misuse of assets, ATATs) and those on this list, any failure that is an EIF may be self-corrected



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Specifically Ineligible for SCP: List

- Notice 2023-43 specifically excludes:
 - Failures to initially adopt a written plan or post-2008 403(b) plan
 - What about participating employers in CG/ASG plans? (We'll discuss.)
 - Failures in orphan plans
 - Significant failures in terminated plans
 - BUT: does not define "terminated plans"
 - upon action to terminate (what if assets aren't paid out within a reasonable time)?
 - upon payout of assets?

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Specifically Ineligible for SCP: List

- Notice 2023-43 specifically excludes (cont.):
 - Failure involving excess contributions to a SEP or SIMPLE IRA where the correction leaves the excess in participant's IRA
 - Failures in SEP/SIMPLE that do not use model or prototype plan document
 - Does that mean they needed to be on model/prototype document when the failure happened or upon correction?
 - Failures under IRC §409 in ESOPs (and, especially §409(p)) that involve tax consequences other than disqualification



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EPCRS Self-Correction Rules That Are Obsolete

- Requirement that the plan have a favorable determination letter or be on a preapproved document
- Exclusion of demographic and employer eligibility failures from self-correction
- Prohibition of self-correction of SEP and SIMPLE significant failures
- Prohibition or limitation on self-correction of loan failures



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EPCRS Self-Correction Rules That Are Obsolete (cont.)

- Time limit on self-correction of significant failures (although limitations on self-correction of significant failures after IRS discovery continue)
 - Note that the Notice provides that the failure is eligible for self-correction, notwithstanding the notice of IRS examination, if the sponsor demonstrated a specific commitment to correct prior to notice of examination



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Questions and Answers on the Notice



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What Does “Identified by the IRS” Mean?

- If the IRS has identified the failure, it is too late to self-correct a significant failure absent a “specific commitment to correct”
- Notice 2023-43 uses the EPCRS definition of “Under Examination”



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“Under Examination”

- Plan is under an Employee Plans examination; or
- Plan sponsor is under an Exempt Organization examination; or
- Plan is under investigation by the Criminal Investigation Division of the IRS; or
- Plan or Plan Sponsor (or authorized representative) has received verbal or written communication of impending examination or referral for examination; or
- Plan/Plan Sponsor in appeals or litigation from something that arose under Employee Plans or Exempt Organization examinations



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What Does “Identified by the IRS” Mean?

- Note: the existence of the examination or future examination is sufficient – the IRS does not have to have actually identified a specific failure to have “identified” the failure
- Insignificant errors can still be self-corrected, even after the plan has been identified by the IRS



What is a “Specific Commitment to Correct?”

- Facts and Circumstances determination
- “Actively pursuing correction”
- Does not include:
 - Completing a compliance audit
 - Having a general statement of intent to correct errors if and when discovered
 - What about hiring a TPA or lawyer to correct a specific failure?
 - Do you need to have already decided on a correction?

Correction Within a “Reasonable Period”

- Notice 2023-43 requires that the failure be corrected within a reasonable period after identification
- “Reasonable period” is facts and circumstances determination
- Notice provides that time is “deemed reasonable” if correction occurs by last day of 18th month following failure identification
 - This should be a “safe harbor”



IMPORTANT



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Correction Within a “Reasonable Period”

- Re: Employer Eligibility Failure
 - What it is: the adoption of a type of plan by an employer that is ineligible to have that kind of plan
 - E.g., governmental organization with a 401(k) plan
 - E.g., non-501(c)(3) nonprofit with a 403(b) plan
 - Absolute deadline to cease contributions in an employer eligibility failure is 6 months after identification



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Side Note

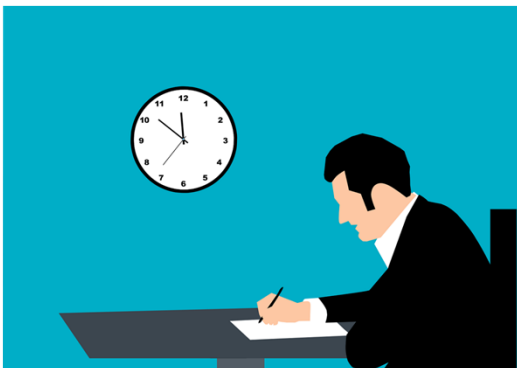
- Notice how important keeping track of identification date is
 - Cannot have made significant commitment to correction of failure until failure identified
 - 18-month period is judged with reference to the date of identification
 - IRS requires that record be kept of the date identified



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Interaction of Identification and Timely Correction



- If the IRS provides notice of examination, how do the “identification” rules and the “timely correction” rule interact?
 - “Timely correction” is a requirement for self-correction, but it is not a factor in determining whether there is a specific commitment to correction so that self-correction is permitted after examination notice is received



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Self-Correction Timing vis-à-vis IRS Exam Avoiding CAP

- Example #1:
 - Plan sponsor identifies failure on Monday
 - On Tuesday, plan sponsor retains legal counsel to help it correct the failure and begins collecting data to send to legal counsel for that purpose
 - On Wednesday, before any additional corrective activity has begun, the IRS issues an examination notice
 - We think the plan sponsor has made specific commitment to correct; self-correction is still permitted



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Self-Correction Timing vis-à-vis IRS Exam Avoiding CAP

- Example #2:
 - Plan sponsor identifies failure on Monday
 - On Tuesday, plan sponsor retains legal counsel to help it correct the failure and begins collecting data to send to legal counsel for that purpose
 - 12 months later, no correction activity has occurred
 - IRS issues exam notice on 12 months and one day
 - Did the failure to act for 12 months negate the specific commitment to correct?



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Self-Correction Timing vis-à-vis IRS Exam Avoiding CAP

- Example #2 (cont.):
 - But, under the notice, the timing of the correction is not a relevant factor to eligibility to self-correct after receipt of IRS notice of examination
 - Plan sponsor has 18 months after plan sponsor identifies the failure to self-correct
 - So, does that mean that the progress of correction during that 18-month period is irrelevant?



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Self-Correction Timing vis-à-vis IRS Exam Avoiding CAP

- Example #3
 - The employer from Example 2 is permitted by the IRS to proceed with self-correction
 - However, the employer continues to dawdle on the self-correction, and 2 years pass from date of identification
 - While the employer was eligible to self-correct, the self-correction process was faulty, and the correction failed; plan is at risk for disqualification



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Self-Correction Timing vis-à-vis IRS Exam Avoiding CAP

- Example #4:
 - Plan sponsor identifies failure on Monday
 - On Tuesday, plan sponsor retains legal counsel to help it correct the failure and begins collecting data to send to legal counsel for that purpose
 - 19 months later, plan sponsor and legal counsel have worked diligently to correct, but factors beyond their control have delayed the correction
 - At 19 months plus one day, the IRS provides notice of examination



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Self-Correction Timing vis-à-vis IRS Exam Avoiding CAP

- Example #4 (cont.):
 - “Reasonable time” is a facts and circumstances determination and “18-month rule” is just a safe harbor
 - The plan sponsor would need to convince the IRS that the correction period of more than 18 months was still a “reasonable time” for correction under the facts and circumstances



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Practices and Procedures

- The IRS requires that the plan have practices and procedures in place when the failure occurred
- EPCRS provides that:
 - The procedures may be formal or informal (but how do you prove the existence of informal procedures?)
 - Must be “reasonably designed to promote and facilitate overall compliance in form and operation” with the Code



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Practices and Procedures

- What we believe is true, although neither EPCRS nor Notice 2023-43 specifically discuss this, is:
 - Having a TPA is not “practices and procedures”
 - As noted above, hard to provide informal procedures, so written is better
 - In addition, the Notice requires demonstration of existing procedures and procedural changes after self-correction to avoid recurrence
 - Procedures can include knowing when to get assistance from service providers



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Practices and Procedures



- Examples:
 - Responsible person at plan sponsor's office has and commonly refers to a calendar of deadlines during the year
 - Payroll department has procedures for properly calculating salary deferrals
 - Client has written procedure for remitting deferrals and loan payments to recordkeeper
 - Client has procedures for requesting or confirming participant loans and distributions



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Practices and Procedures



- Examples:
 - Plan sponsor has a “phone tree” of which provider to call for which issues
 - Plan sponsor has designated the person in its office that is to respond to participant requests for information or benefit payments
 - Plan sponsor has designated substitutes to take plan action if the person to whom responsibility is assigned is out of the office or unavailable
 - Annual review of plan documents with provider to ensure they are up to date



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Is VCP Obsolete?

- No. BUT, you may still want to file if:
 - You do not know the proper way to correct
 - The plan sponsor has no demonstrable practices and procedures, so self-correction eligibility is in question
 - The error is one of those excluded from self-correction
 - Plan sponsor (or other concerned party, such as buyer) is nervous
 - You're concerned that you've exceeded a "reasonable time" to self-correct
 - Plan sponsor wants to use an unorthodox correction method, such as creating a cutback for the owner



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Notes on Correction Methods

- Must follow general EPCRS §6 principles
- Can use corrections specified in Appendix A or B
 - Not required to do so



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How Are Demographic Failures Corrected?

- The notice provides that demographic failures must be corrected using the method under Treas. Reg. §1.401(a)(4)-11(g)
 - **Retroactive corrective amendment**
 - Benefits and BRFs not reduced from plan terms in effect immediately before the amendment
 - Amendment effective as if made on the first day of the plan year being corrected
 - Requires increase in benefits or entry of additional participants to meet coverage



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How Are Demographic Failures Corrected?

- Treas. Reg. §1.401(a)(4)-11(g) (cont.)
 - **Corrective amendment:**
 - Must be adopted and implemented within 9½ months of close of plan year for which it applies
 - n/a for self-correction (if 9½ months rule is met, no need for EPCRS)
 - Retroactive benefits must be provided to a nondiscriminatory group
 - If BRF, amendment must eliminate BRF or expand the group of employees to whom the BRF is available



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How Are Demographic Failures Corrected?

- Treas. Reg. §1.401(a)(4)-11(g) (cont.)
 - **Corrective amendment:**
 - If correcting a coverage requirement for a 401(k)/401(m) plan:
 - Must grant QNECs to NHCEs to who eligibility is extended to meet coverage
 - Amount: NHCE compensation for the plan year x ADP (or ACP) for NHCEs for the year (no reduction of percentage, as is permitted for failure to permit deferral)
 - Amendment must have substance



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How Are Demographic Failures Corrected?

- Treas. Reg. §1.401(a)(4)-11(g) (cont.)
 - **Note:** 1.401(a)(4)-11(g) does not discuss earnings on additional contributions, but EPCRS requires earnings for self-correction
 - **Notice 2023-43 says sponsor may not correct**
 - “using a special testing provision set forth in §1.401(a)(4)-8 [cross-testing] or §1.401(a)(4)-9 [DB/DC Combo or restructuring]”; or
 - By providing benefits primarily to short-service or low-paid employees



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How Are Demographic Failures Corrected?

- Treas. Reg. §1.401(a)(4)-11(g) (cont.)
 - Re prohibition on cross-testing, DB/DC combo, or restructuring:
 - What if the plan always used those techniques in the past, but simply made an error that caused the demographic failure ...
 - Does that mean that you must correct without these techniques?
 - If so, can you VCP to retain those techniques?



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Can All Document Failures Be Self-Corrected?

- As noted earlier, cannot self-correct failure to initially adopt plan
 - Ongoing question: what about related employer's failure to adopt controlled/affiliated service group plan?
 - Is this a failure to initially adopt or an operational failure of covering people not eligible to participate?
 - Because plan has been adopted by "employer" (under CG/ASG rules), we believe it is an operational failure that can be self-corrected



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Can All Document Failures Be Self-Corrected?

- Can self-correct failure to amend timely for law changes/restatement cycle
 - We believe that the rules outlined by IRS in prior guidance continue to apply to late restatements
 - Must treat plan as individually designed after cycle ends and update for unadopted remedial amendments to be “requalified” for interim period
 - May then restate back onto preapproved plan and have reliance for future periods



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Correction of Operational Failures by Amendment

- Plan does not operate according to its terms and client wants to amend the plan to match operations
 - Not a document failure, but the correction of an operational failure by amendment
 - Historically, such self-corrections were limited by EPCRS
 - Notice permits self-correction of operational failure by amendment to align plan with actual operations
 - No benefit may be less favorable to participant than under original provisions
 - No limitation to BRF issues



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Correction of Operational Failures by Amendment

- Example #1
 - Plan provides for eligibility of 1 year, age 21
 - For years, the plan sponsor has allowed people to participate immediately upon hire
 - Plan may be amended retroactively to change eligibility to match actual operations
 - Must satisfy coverage before and after amendment



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Correction of Operational Failures by Amendment

- Example #2
 - DB Plan and PS plan are cross-tested together and pass cross-testing with flying colors
 - Company owner bemoans that he did not amend the DB plan before year end to increase benefits to the highest level that the cross-testing results would permit
 - Secure permits adoption of amendment to increase benefits by tax return due date, but we are past that – this guy really dawdled
 - Cannot amend plan now, because he did not operate the plan with the increased benefits



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Correction of Operational Failures by Amendment

- Example #3
 - Company sponsors DB plan for its employees
 - The valuation for the DB was done for years excluding an employee who the TPA thought worked fewer than 1,000 hours (she didn't)
 - The cost of correction (i.e., of providing the benefit that she would have earned) is \$50,000
 - Plan sponsor wants to amend the plan to retroactively exclude her
 - Plan coverage would be met even if she were excluded



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Correction of Operational Failures by Amendment

- Example #3
 - Not permitted
 - Even though this matches plan documentation to operations, this is providing a lower benefit to a participant than would be provided under the existing plan terms
 - Violates anti-cutback rule



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Self-Correcting Loan Failures

- Loan failures generally result in taxable income to the participant
- Historically, could only avoid this result through self-correction in limited situations; otherwise, VCP needed
 - Could self-correct loan default
 - Could not self-correct excess loan or loan with due date after 5 years
- Under Notice 2023-43, can self-correct all loan EIFs
- How does one self-correct various loan failures?
 - Follow principles of EPCRS §6.07



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Self-Correcting Loan Failures

- Issue #1: We let people take loans and the plan did not allow
 - Amend the plan to match operations
 - Can limit amendment to permitting loans by just the people who actually took them, if they are NHCEs
 - Be careful of discrimination issues in general with this
 - If only the owners knew about loan availability, the amendment won't fix the lack of availability to other employees



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Self-Correcting Loan Failures

- Issue #2: The loan exceeded limits
 - The excess loan is taxable (and can issue Form 1099-R for current year or the year in which the loan was issued)
 - Can correct by repaying the excess portion of loan now



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Self-Correcting Loan Failures

- Issue #3: The loan was not repaid timely
 - Can consider the outstanding loan to be income in current year rather than in year of default
 - Must adjust for accrued interest to date deemed
 - If we are within 5 years of the loan's initial issuance, can reamortize loan over remaining portion of the 5-year period
 - Participant can pay all o/s amounts now, and continue payments as due
 - If loan is > 5 years, participant can repay entire loan + interest now and avoid taxation

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Self-Correcting Loan Failures

- Issue #4: There was no loan documentation, but loan was administered in conformance with IRC §72(p) otherwise
 - Can this be corrected by having documentation signed retroactively to match how the loan was treated?
 - Can we avoid taxation by having the participant immediately repay the loan in full?
 - Do we have a PT because we violated plan provisions?
 - Was this a disguised distribution?



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Recordkeeping Requirements



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Notice 2023-43 Requires Certain Records

- Plan must document:
 - The failure, including years of occurrence, and the number of affected employees
 - Date when failure was identified by plan sponsor
 - Explanation of how the failure occurred
 - Demonstration of existence at the time of the failure of practices and procedures that were reasonably designed to promote and facilitate overall compliance



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Notice 2023-43 Requires Certain Records



- Plan must document (cont.):
 - Identification and substantiation of correction method
 - Must include date of correction
 - Changes made to practices and procedures to avoid recurrence



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Closing Thoughts



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- After the webcast you will be presented with a short Google Forms survey. Please let us know how we are doing.



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For Further Study

- Joanne Pecina will demonstrate how to find more information on today's topic from the ERISApedia.com resources.



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