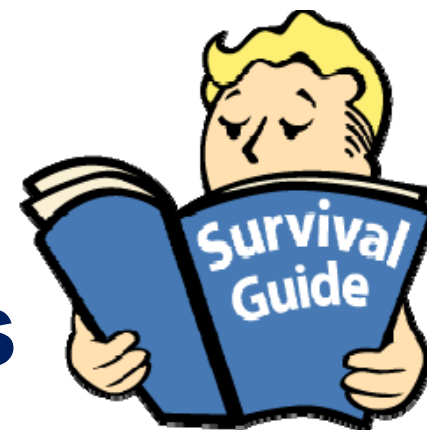


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# EPCRS PART II

## Correction Tips and Tricks



Ilene H. Ferenczy, Esq., CPC, APA  
Timothy McCutcheon, Esq., CPA, MBA

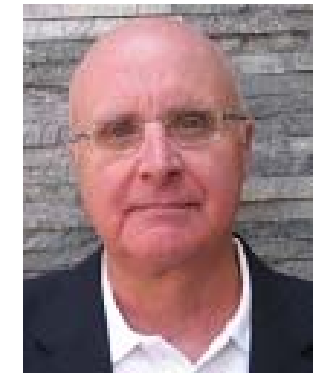


# Your Presenters Today

- Ilene H. Ferenczy, JD, CPC, APA



- Tim McCutcheon, JD, CPA, MBA



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# EPCRS PART I

## Correction Tips and Tricks

- Facilitator:  
Chuck Gouge



- Question Board Moderator  
Joanne Pecina



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# During the Webinar

- All attendees' lines are muted
- Question board available and monitored
  - Please send in questions
  - We will answer as many submitted questions as possible
- Follow up questions and comments can be sent to:
  - [support@erisapedia.com](mailto:support@erisapedia.com)

# Agenda

- Correction Tips and Tricks
- ***Voluntary*** demo after presentation
- Covering Chapter 21 of the Qualified Plan eSource authored by Ilene Ferenczy





# EPCRS PART II

## CORRECTION TIPS AND TRICKS



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# Quick Review from Last Time (Part I)



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# What Can Cause a Plan to Be Disqualified?

- Plan document failure
  - Something isn't in the plan document that must be (e.g., PPA restatements)
  - Something is in the plan that shouldn't be
- Operational failure: didn't follow the terms of the plan document



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# What Can Cause a Plan to be Disqualified?

- **Demographic failure:** failed coverage, participation, or nondiscrimination requirements
- **Employer eligibility failure:** e.g., governmental entities cannot sponsor 401(k) plans, for-profit organizations cannot sponsor 403(b) plans

# EPCRS

- Acronym for **Employee Plans Compliance Resolution Program** – IRS-approved method for correcting qualification errors
- Latest version: Revenue Procedure 2016-51



# EPCRS Structure

- Three correction procedures:
  - Self correction procedure (“SCP”)
    - Insignificant errors: anytime
    - Significant errors: time limited
  - Voluntary submissions to IRS (“VCP”)
    - Forms 8950 and 8951
    - Cannot be “under examination”
  - Audit Closing Agreement Program (“CAP”)



# Self-Correction Procedure:

- If outside two-year correction period, can only self-correct if error is insignificant
- What is “insignificant?” Balancing of factors:
  - Have other failures occurred?
  - % of plan assets and contributions involved
  - Number of years affected
  - Number of participants affected (as % of total in plan and as % of those who could have been affected)
  - Was correction made within a reasonable time after discovery?
  - Why did the failure happen?

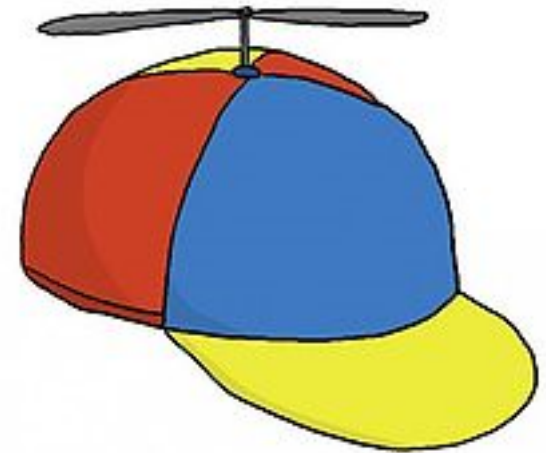
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# VCP

- Plan sponsor submits a plan to the IRS for coordinated correction process
- Fee payable
- Plan must be eligible for the program
- No correction applies until after approval granted under VCP program (correction letter)

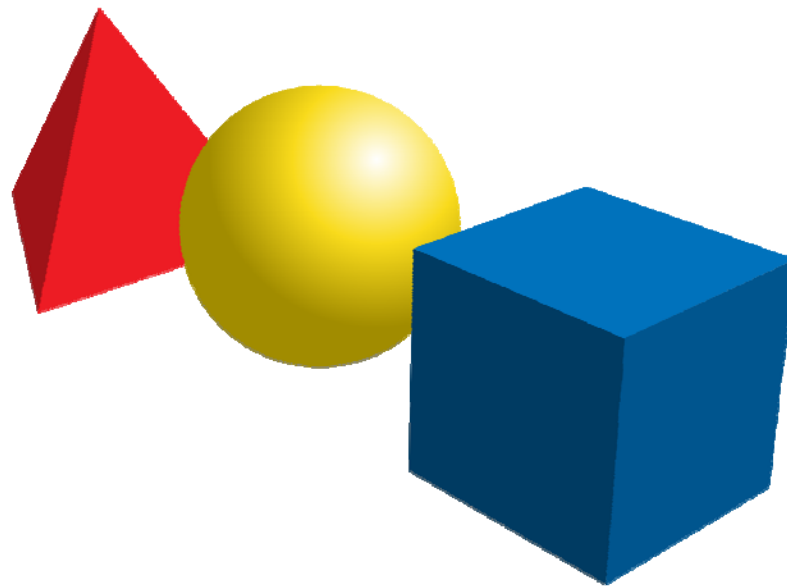
# Audit CAP

- IRS discovers problem on audit
- IRS and plan sponsor enter into a contract called a “Closing Agreement” to correct the problem
- Sponsor pays a sanction to the IRS



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# Correction Basics



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# How Do You Correct?

- EPCRS (Revenue Procedure 2016-51) contains pre-approved correction methods for some errors
  - Following these methods is safe
- Otherwise, find reasonable, appropriate method
  - Follow correction principles discussed in EPCRS
  - Use Code, regs, and EPCRS as a guide
  - Correct discrimination failures by giving to NHCEs
- Note: the farther you get from pre-approved methods, the more beneficial it is to ask for IRS approval



# Correction Principles

1. Must correct all taxable years (even if closed)
2. Restore plan and participants to position they would have been in had the failure not occurred
3. Should be reasonable and appropriate - Appendix A/B deemed reasonable
4. Consistent with IRC (don't create another violation)
5. Provide benefits to NHCEs
6. Keep assets in plan
7. Consideration of other agencies (e.g., DOL on abandoned plans)

# Correction Principles - Exceptions

- Requirement:
  - No significant adverse effect on participants
  - No significant discrimination in favor of HCEs
- Not an exception: correction would be inconvenient or burdensome
- Estimates okay if:
  - Cost of precise calculation outweighs probable difference or
  - Precise calculation is not possible

# Correction Principles - Exceptions

- Corrective distribution of \$50 or less is not needed if cost of processing and delivering exceeds the correction. Amounts not distributed are allocated to other participants
  - Applies only to distributions – not earnings calculation
- Must take reasonable actions to locate lost participants and beneficiaries (WWYDITWYM)



# Lost Earnings

- Corrective contributions, allocations or distributions must be adjusted for earnings
- Don't have to adjust for losses, but can
- Assume that the date on which the earnings begin:
  - Date on which contribution/forfeiture would have been allocated to the participant's account
  - For salary deferrals and after-tax contributions, assume mid-point of plan year (or period of exclusion)

---

# Lost Earnings

- Methods for determining earnings:
  - Generally use actual earnings based on EE's investment choices
  - Reasonable estimates of investment returns
  - Multiple investment options – option w/highest rate of return (if most EEs are NHCEs)
  - If EE has no investment selections – average of all investment options
- Can the DOL's online VFCP calculator be used?

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# Failure to Enroll/Enter



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# Failure to Enroll a Participant in a Non-401(k) Plan

- DC Plan:
  - Option #1: employer contributes enough to give the participant contribution, forfeiture allocation, and earnings as if s/he was properly enrolled in the plan
  - Option #2: if PSP, contribution and forfeitures are reallocated to all participants as if proper employees were in the allocation
    - Accounts adjusted (over-allocations removed to pay for under-allocations)
- DB Plan: give participant accrued benefit



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# Failure to Enroll a Participant in a 401(k) Plan

- The ABC Company's 401(k) plan operates on a calendar year with monthly entry
- Margaret was due to enter 1/1/16, but the company forgot to enroll her
- Correction depends on whether the plan uses automatic enrollment



# No Deferral: Auto Enrollment

If	Correct Deferrals	Notice to Employee	Result
Found within 9½ months after PYE of failure (i.e., extended 5500 deadline)	Begin by no later than 1 <sup>st</sup> payday on or after 9½ months after PYE	Within 45 days after correct deferrals begin	<ul style="list-style-type: none"> <li>• No QNEC</li> <li>• Contribute missed match plus earnings within 2 years after PYE of failure</li> <li>• Earnings: actual election or default fund (but not negative)</li> </ul>
Employee notifies ER of failure earlier than above	Begin by the first payday for the month following the month of notification		

Note: this correction will sunset in 2020 unless IRS acts to extend (want to see increase in auto enrollment)

# No Deferral: 3-Month Rule

If	Correct Deferrals	Notice to Employee	Result
Found within 3 months after failure first occurs	Begin by no later than 1 <sup>st</sup> payday on or after 3 months after failure occurs	Within 45 days after correct deferrals begin	<ul style="list-style-type: none"> <li>• No QNEC;</li> <li>• Contribute missed match plus earnings within 2 years after PYE of failure</li> <li>• Earnings: actual election or default fund (but not negative)</li> </ul>
Employee notifies ER of failure earlier than above	Begin by the first payday for the month following the month of notification		

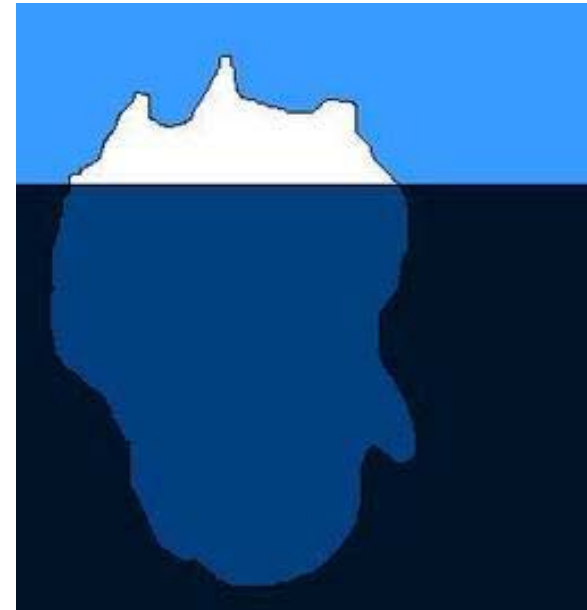


# No Deferral: 2-Year Rule

If	Correct Deferrals	Notice to Employee	Result
Found within self-correction period (2 years) after end of the plan year in which failure occurs	Begin by no later than 1 <sup>st</sup> payday on or after 2 years following PYE of failure	Within 45 days after correct deferrals begin	<ul style="list-style-type: none"> <li>• QNEC = 25% of missed deferral;</li> <li>• Contribute missed match plus earnings within 2 years after PYE of failure</li> <li>• Earnings: actual election or default fund (but not negative)</li> </ul>
Employee notifies ER of failure earlier than above	Begin by the first payday for the month following the month of notification		

# If No Safe Harbor Applies

- QNEC = 50% of missed deferral
- Contribute the full match
- Earnings
- EE Notice



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# What Is Missed Deferral?

- If Margaret made deferral election but no deferral taken, missed deferral is the amount elected
- If there is auto enrollment and Margaret made no election, missed deferral is rate of auto enrollment
- If no election and no auto enrollment, missed deferral is ADP of group (NHCE/NCE) times compensation for the relevant period.

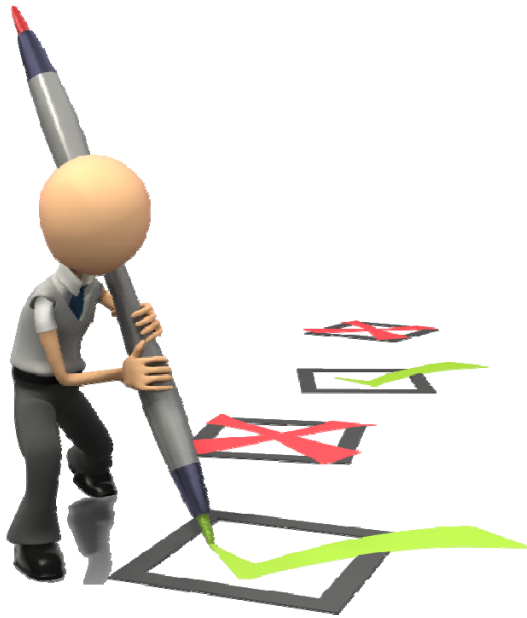


# Earnings

- In any event, the plan must provide Margaret with earnings on missed contributions
  - What the employee would have earned based on his/her investment choices
  - If mostly NHCEs are affected, can use highest earning fund for period of failure
  - If the employee did not make an investment choice, use rate of return for plan as a whole
  - VFCP rate?



# Can We Self-Correct the Error?



- Same as previous facts, except:
- Error not found until late 2018 (> self-correction period)
- Error found because IRS has notified ABC Company of an audit and TPA is preparing for the audit

---

# Still Self-Correctable?

- Depends on whether the error is significant
  - Insignificant errors may be self-corrected anytime
  - Significant errors may be corrected within two years, but an audit terminates the self-correction period





# Can We Argue That This Is Insignificant?

- Factors:
  - Have other failures occurred?
  - % of plan assets and contributions involved
  - Number of years affected
  - Number of participants affected (as % of total in plan and as % of those who could have been affected)
  - Was correction made within a reasonable time after discovery?
  - Why did the failure happen?

# Keys to Analysis



- How many people became eligible and how many enrollments were missed?
- Does this problem arise all the time, or was this an isolated problem?
- Why did it take two years to find the mistake?
- How compliant is the plan generally?

# Forfeiture Use

- Can we use forfeitures in the Plan for the corrective amounts?
- Corrective allocations should come only from employer nonelective contributions – including forfeitures if the plan permits their use to reduce employer contributions.
  - If contributing missing QNECs and safe harbor contributions, can use forfeitures to fund (new proposed IRS regs §1.401(k)-6 issued earlier this year)

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# Impermissible or Out-of-Compliance Loans



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# Loans Without Permission

- The GHI Company's 401(k) plan does not permit participant loans
- TPA takes over the administration of the plan effective 1/1/17, and finds that three loans were given to participants during 2016 in violation of the plan
- What to do?



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# Correction Analysis

- Within self-correction period?
  - Yes, self-correction period ends 12/31/17
- How to correct?
  - EPCRS permits three corrections by retroactive plan amendment under self-correction
  - One is the ability to retroactively add loan or hardship provision when loans or hardships were permitted in error

# Correction Analysis

- At some point prior to 12/31/17, GHI Company adopts an amendment to permit participants to borrow from the plan, effective retroactively to January 1, 2016
- Does GHI have to open up loans to everyone?
  - If the borrowers are NHCEs (i.e., the impermissible loans were not discriminatory), may:
    - Justify only the loans that were made or
    - Offer to all
  - If borrowers were HCEs, need to ensure nondiscriminatory BRFs (better to open to all)

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# Bad Allocation! Bad!



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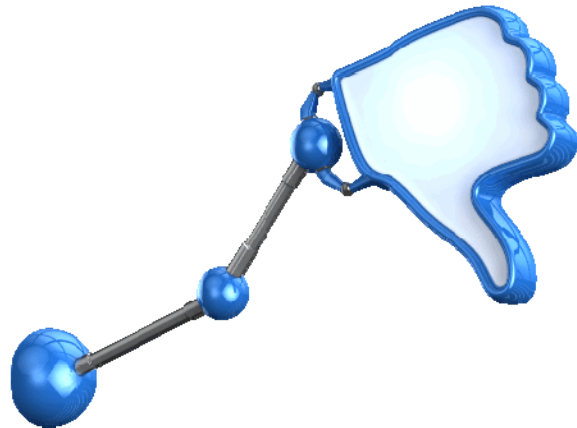
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# Bad Allocation

- JKL Company has a profit sharing plan that has tiered allocations
- Under the plan forfeitures are allocated to participants who were participants in the prior year and are employed at the end of the current year
- The TPA gave forfeitures to all participants from 2011-2014
- The error was discovered in 2017

# Is Self-Correction Possible?

- Because the error happened in years that are outside the two-year correction period, self-correction is not permitted
- Must file a VCP if want to fully correct



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# What if No VCP Is Filed?

- If no audit by IRS, probably nothing
- If plan is audited and issue is discovered:
  - IRS will likely permit a valid correction to requalify the plan, but will threaten disqualification for years outside the permissible correction period
  - Sanction will likely be more than VCP fee, but less than it would have been had no correction been made

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# Correction Analysis

- Must put participants back to where they would be had the allocations been done correctly
- New entrants received allocations to which they were not entitled
- Existing participants did not receive as much as they should have

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# Standard Correction


- Determine what the allocations should have been
- Remove overallocations from accounts of remaining participants and allocate those amounts to the people who were “shorted”
- If a terminated participant was overpaid:
  - Request repayment of excess
  - If no repayment, company must make up the excess and send revised Form 1099R, reflecting that overpayment is not eligible for rollover

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# Standard Correction Earnings

- Actual
- If cannot do actual, need to consider:
  - Need to make sure that people who are giving up money are not being overcharged
  - Need to make sure that people who are getting money are getting sufficient earnings
  - May end up with different rates on removals from accounts and additions to accounts
  - Company will need to make up the difference

# Variations on the Standard

- Can we make a larger deposit and not reduce the accounts of the employees who got excess allocations?
  - Does not put people in the position in which they would have been, but permits some participants to keep allocations that were more than they should have been
  - This is a variation on the standard correction and may not be approved by the IRS (especially if some of the affected folks are HCEs)

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# Variations on the Standard

- Makes VCP submission more important
- Cannot be certain what the IRS would permit and, if we are wrong, the correction is another disqualifying failure
- Things to consider:
  - Effect of alternate correction on HCEs
  - If it gives them more, this may be disfavored by IRS
  - Does it produce a current §404 or §415 problem?

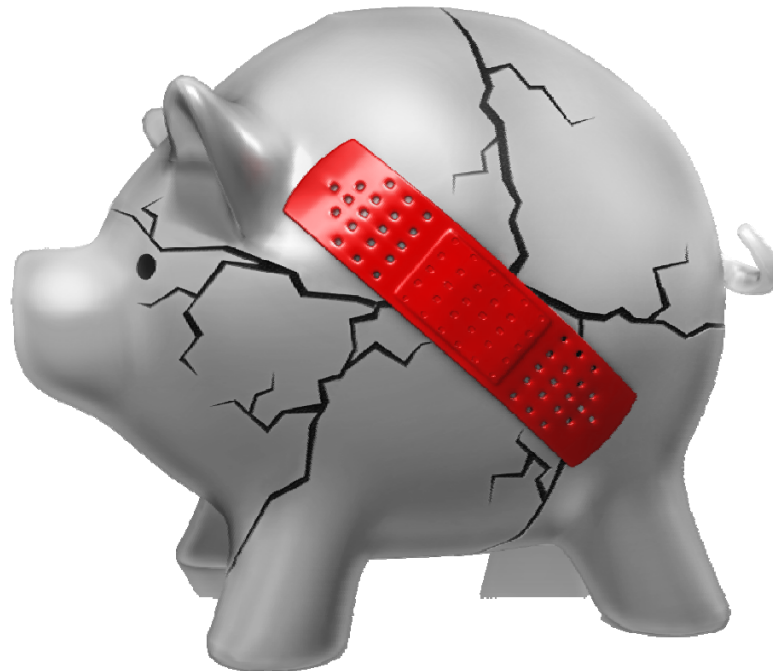


# Variations on the Standard

- What if JKL does not want to do the correction in the “normal” way – even if the IRS were to insist?
- Consider anonymous submission program
  - If IRS does not want to permit the desired correction, can negotiate a mutually acceptable resolution
  - If come to an agreement, can disclose client and finalize VCP
  - If no agreement at all, can revoke submission without revealing client identity

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# Failure to Amend



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# Failure to Restate

- TPA is taking over the administrative work for MNO Company's 401(k) plan
- Despite the best efforts of the client, the prior service provider, and the client's lawyer, no one can find a signed copy of the PPA restatement (it was due 4/30/16)
- What should be done?



# EPCRS Nonamender Program

- Document problem: must VCP
- If submitted within one year of the expiration of the RAP, VCP fee is reduced 50%
- If unadopted amendment is good faith amendment, interim amendment, or amendment required for optional law changes, VCP fee is \$375
- If unadopted amendment relates to conditional FDL, VCP fee is \$500\*

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# Scrivener's Error (or Not)



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# Scrivener's Error

- VWX, Inc. hires TPA to take over its plan administration in 2016
- TPA restates the VWX, Inc. plan onto its prototype
- After the plan is restated, the client services manager realizes that there was an error – the matching contribution should have been 50% and the document was prepared showing 100%

# Key Issue



- The IRS does not consider this to be the correction of a “scrivener’s error,” i.e., an error in drafting that is being corrected
- The IRS considers this to be an operational failure (i.e., failure to follow plan terms) that the employer would like to correct with a plan amendment to match actual operations

# Considerations

- IRS thoughts:
  - Is there any extrinsic proof that the higher match provision was unintentional?
    - The service representative provided the plan sponsor with a chart of provisions, showing the 50% match, and the sponsor signed off on it
    - The client considered raising the match, but sent an email to TPA that said, “We’ve decided against the higher match; please keep the match rate at 50%.”
  - What was communicated to employees (i.e., what are their expectations?)



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# Considerations

- For the employer:
  - EPCRS expressly applies to the IRS only
    - Not DOL
    - Not participants
  - Notwithstanding the intent of the employer, the scrivener amendment may or may not be considered by the courts to be valid retroactively if the participants sue
  - Is it better to just bite the bullet for 2016 and to make the contribution?

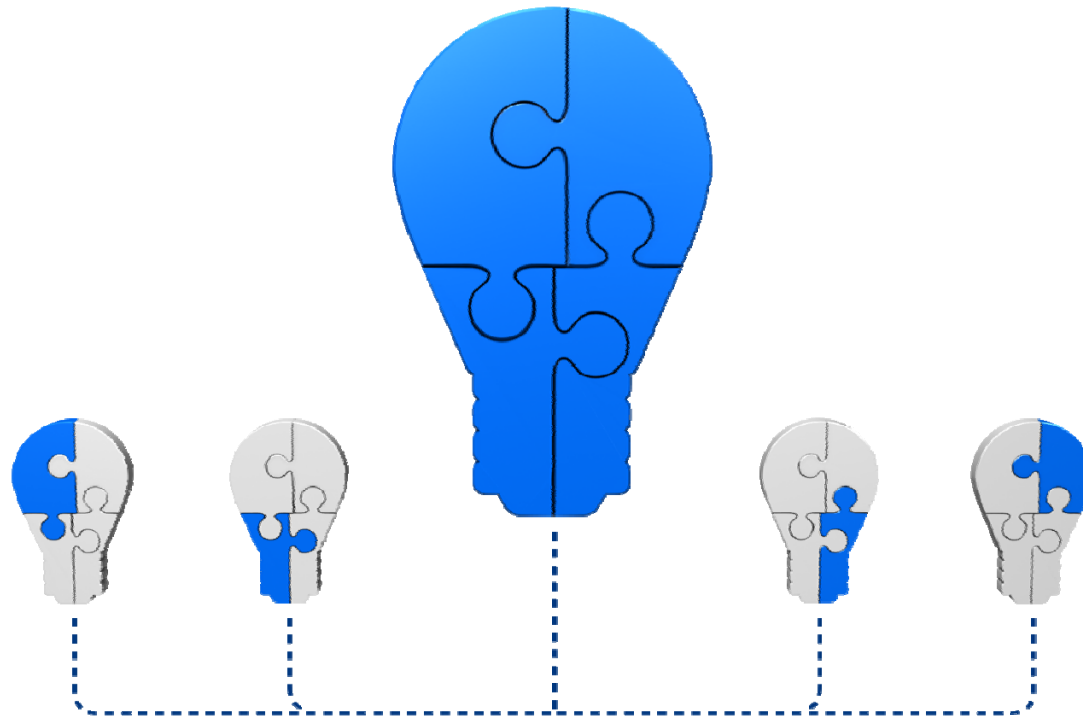
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# Considerations

- For the employer:
  - Who will pick up the cost of the VCP filing and user fee OR the cost of the additional contribution if we just “go with it” for 2016?
- For TPA:
  - Be careful: if there is malpractice insurance, admitting the error may void the coverage

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# M&A and Failure to Enroll



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# Acquired Employees

- In 2016, YZZ Co. acquired the stock of Delta Co.
- Delta employees began participating in the YZZ Plan at the time of acquisition (service with Delta was counted)
- This was all news to TPA
- What to do?



# Acquired Employees

- Read the document:
  - Possibility #1: Participating employers must sign participation agreement.
  - Possibility #2: All members of the controlled group automatically participate.
    - Immediately
    - End of §410(b)(6)(C) period
  - Possibility #3: Related employers participate with consent of plan sponsor.

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# Acquired Employees

- Assume participating employers must sign participation agreement.
- Correct by plan amendment under SCP?
  - No. Amendment only applies to early inclusion of *otherwise eligible employee*. The employees of Delta are not in an eligible class.
- Correct by plan amendment under VCP?
  - Need to convince IRS that amendment is needed for Section 410(b) coverage purposes

# Acquired Employees

- Assume same facts as above except all members of the controlled group automatically participate end of §410(b)(6)(C) period
- Transition period ends on the last day of plan year following year during which acquisition occurred.
- A transition period terminates immediately if the plan is amended:
  - Per the Code: to change coverage
  - Per the regs: to make a material change

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# Acquired Employees

- Transition period otherwise ends 12/31/17.
- The YZZ Co. amended the plan to make it a safe harbor plan effective on 1/1/17.
  - Transition period is likely terminated on 1/1/17.

2016 2017





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# OMG! They Found the Error on Audit!



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# Error Found On Audit

- Insignificant
  - Use SCP
  - No penalty
- Significant
  - Closing Agreement Program (“CAP”)



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# Closing Agreement Program

- **Generally** similar VCP except negotiated sanction (that is usually higher than VCP fee)
- Calculation of sanction:
  - 10 factor test that includes Maximum Payment Amount (taxes due on disqualification)
  - Argue equities (i.e., fairness)
  - Do not be unrealistic, but be persuasive

# Qualified Plan eSource Ch 21

## – Errors covered:

- A Nonamender Failure
- Hardship Distributions When Plan Does Not Allow
- An Employer Eligibility Failure
- A Failure To Obtain Spousal Consent
- 415 Violations
- Excess Allocations
- Overpayment (Defined Contribution Plans And 403(b) Plans)
  - Overpayment (Defined Benefit Plans)



# Qualified Plan eSource Ch 21

- Failure to Make Timely Required Contributions to a Money Purchase or Target Benefit Plan
- Loan Failures
- Improper Exclusion of Employees from Participation
- Early Inclusion of Otherwise Eligible Employee Failure
- Top-Heavy Minimum Benefit/Contribution Failure under Code Section 416
- ADP/ACP Test Failures
- Failure to Provide a Safe Harbor Notice
- Code Section 402(g) Elective Deferral Limit Failure

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# Qualified Plan eSource Ch 21

- §401(a)(9) Minimum Distribution Failure
- Vesting Failures
- Section §401(a)(17) Compensation Limit Failures
- Correction for 403(b) Plans
- Correction for SEPs and SIMPLE IRA Plans
- Correction for Orphan Plans; Orphan Contracts and Other Assets
- Waiver of Excise Taxes

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# Questions?



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# CE Credit

- ERPA/ASPPA/NIPA
  - Will receive certificate by email in several days
  - ERPA will take longer (please be patient)
  - Please check spam folder
- Any questions, email: [support@erisapedia.com](mailto:support@erisapedia.com)



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