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Volume 38 | Issue 53 | April 8, 2015

Early Correction of Elective Deferrals Less Costly Under New EPCRS Options

IRS has again responded to public comments on their retirement plan correction procedure with expanded options to help sponsors keep their plans in compliance at a reasonable cost. Three new options for savings plans reduce the corrective contribution required to compensate employees for their missed deferral opportunity when deferral elections or automatic contribution triggers are not properly implemented.

Background

Under IRS' Employee Plans Compliance Resolution System (EPCRS), plan sponsors are offered a number of standard correction approaches when an eligible employee is excluded from making elective deferrals under the sponsor's 401(k) or 403(b) arrangement. In addition to correcting the defect going forward, the sponsor is required to make a Qualified Nonelective Contribution (QNEC) to replace the employee's "missed deferral opportunity." The QNEC is 50% of the missed deferral. In addition, the sponsor provides the plan's match on the missed deferral opportunity and adjusts both corrective contributions for earnings.

IRS has heard in comments that the cost of correcting failures has discouraged the adoption of automatic contribution and automatic escalation arrangements. In addition, comments have noted that the 50% contribution for the missed deferral opportunity is a windfall to the employee. This is because they receive their full salary in addition to the make-up contribution, and yet usually still have the opportunity to increase their deferrals in later periods.

The most recent complete overhaul of EPCRS was issued in Revenue Procedure 2013-12. At the end of March, in response to public comment, IRS modified certain compliance fees and clarified certain repayment correction rules under EPCRS with Revenue Procedure 2015-27. Our *For Your Information* from April 2, 2015 discussed those changes.

Three New Correction Options

Following on the heels of the fee and repayment changes, IRS has responded to the concerns raised about the cost of correcting elective deferral defects in Revenue Procedure 2015-28. The revision offers plan sponsors the following three additional options for making corrections — two permanent, and one that may sunset.

Plans with Automatic Contribution Feature

For a plan with an automatic contribution feature that fails to implement the contribution for an eligible employee, the EPCRS correction is to provide a corrective contribution to make up for any missed matching contribution, adjusted for earnings. No QNEC is required for the missed deferral opportunity. Correct deferrals must begin by the first payroll period after 9½ months post plan year end (the Form 5500 due date). In addition, the affected employee must be notified within 45 days of beginning the correction.

Rolling Three Months

For elective deferrals under any 401(k) or 403(b) plan — even if there is no automatic contribution feature — the failure to implement the correct amount of deferrals can be fixed without providing a QNEC for the missed deferral opportunity by catching the mistake within three months and starting correct deferrals by the first payroll following the three-month anniversary of the breach. (This is in contrast to the current procedure that waives the QNEC only if the failure occurs within the first three months of the plan year.) The eligible employee is provided a corrective contribution to make up for any missed matching contribution, adjusted for earnings. The affected employee must be notified within 45 days of beginning the correction.

Significant Failure Deadline

Also for elective deferrals under any 401(k) or 403(b) plan — even if there is no automatic contribution feature — the failure to implement the correct amount of deferrals can be fixed after the three-month deadline with a 25% QNEC. This contribution is provided along with a corrective contribution to make up for any missed matching contribution and an adjustment for earnings. The deadline for implementing the correct deferral rate is the first payroll after the last day of the second plan year following the year of the failure. This deadline aligns with the correction period for self-correcting significant failures. If the plan sponsor misses the deadline, then the current 50% QNEC applies.

> **Comment:** The IRS recognizes that a QNEC for the missed deferral opportunity is a windfall for employees but takes the position that it's justified as a penalty for plan sponsors who do not promptly address administrative errors.

Earlier Deadline if Notified by Employee

With all three of the above new correction approaches, an earlier deadline may apply if the eligible employee notifies the plan sponsor that an affirmative deferral election has not been correctly implemented. In this case, correct deferrals must start by the first payroll on or after the end of the month following the month of notification.

Calculation of Earnings

The revenue procedure provides an alternative method for calculating earnings for plans that have automatic contribution features. The method can be used with any of the three new options. Under the alternative, if no affirmative designation has been made, missed earnings may be calculated using the plan's default investment alternative, except that cumulative losses may not reduce corrective matching contributions.

Sunset After 2020

The new safe harbor correction for plans with automatic contribution features will sunset after 2020. At that time, IRS will evaluate whether to continue the safe harbor, in part based on whether it achieves the goal of removing impediments to the adoption of automatic contribution arrangements.

Effective Date

The new correction options are effective April 2, 2015. The revenue procedure does not limit the options to new defects on or after that date so it would appear they can be used for any outstanding breaches that can fit within the new framework and be corrected in the corresponding timeframes.

> **Comment.** Although the 45 day notice requirement could limit availability for breaches identified and partially corrected in prior periods, it should be recalled that the EPCRS correction principles generally call for a correction that is "reasonable and appropriate for the failure." Correction methods in the Appendices (where the current revenue procedure adds the three new rules) are deemed reasonable. So missing the notice requirement may prevent using the option from being a deemed reasonable safe-harbor, but won't necessarily mean that it is not reasonable and appropriate for the failure.

In Closing

With two revenue procedures in a week's time offering improvements to EPCRS, plan sponsors have new incentives to correct plan errors. The elimination of the 50% QNEC for plans that can meet the specified deadlines for addressing failures could be key in spurring on the adoption of more automatic contribution arrangements.

Volume 38 | Issue 53 | April 8, 2015

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