New EPCRS Options to Correct Deferral Errors

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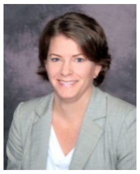

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One of the most common errors in 401(k) and 403(b) plan administration is when an employee elects to contribute to the plan or elects to change his contribution amount and his election is not timely implemented in the payroll system. A related error that is also common is the failure of the employer to inform an employee of his eligibility to start contributing to the plan when he meets the plan's eligibility requirements.

Fortunately, the Internal Revenue Service (IRS) has provided relief for these errors via the Employee Plans Compliance Resolution System ("EPCRS"). The EPCRS is a system of IRS approved corrections that allow sponsors of retirement plans to resolve various types of failures and still continue to maintain the plan's tax-favored status.

There are three components to the correction program:

- Self-correction (SCP) – insignificant errors that the employer can correct without any reporting obligations, fees or sanctions;
- Voluntary correction (VCP) – errors that may be corrected by paying a limited fee; and
- Correction on Audit (Audit CAP) – errors that are identified on audit, but may still be corrected by paying a sanction.

Missed deferrals generally may be corrected under SCP.

The most recent EPCRS was released in 2012 and prescribes that if an employer fails to implement an employee deferral election or fails to make an employee aware of his eligibility to defer, it must fund a contribution of 50% of an assumed missed deferral amount, plus any match the employee would have received had ALL of his deferrals been deposited, plus applicable earnings up to the date of correction.

The Treasury and IRS have increasingly encouraged plan sponsors to adopt automatic enrollment features to help employees save for retirement. However, employers have been reluctant to implement automatic features because of the increased risk of missing a deferral election and the high cost associated with correcting a missed deferral under the current EPCRS remedies.

After reviewing comments from the public, in early April, 2015 the IRS modified the EPCRS language to add correction options for deferral errors related to automatic contribution features and to reduce the required corrective contribution for some missed deferrals that are of a limited duration. The modifications, found in Rev. Proc. **2015-28** supplement the EPCRS, which is found in Rev. Proc. **2013-12**. The modified rules do bring welcome relief for plan sponsors seeking to correct deferral errors. However, since the modifications were issued as a subsequent Rev. Proc. that must be considered in combination with the earlier EPCRS Rev. Proc., the rules have become more difficult to follow, as you have to look at both Rev. Procs. to determine the correction options. A new, updated EPCRS that combines all of the options and eliminates language that is no longer applicable (and ideally streamlines the rules into a comprehensive chart format) is greatly warranted. In addition, the new rules provide additional correction provisions that are only available to plans that use automatic enrollment, which muddies the waters when it comes to determining which correction option is appropriate. Some areas that seem unclear:

- Where do missed **after-tax contributions** fit into the new rules? References in EPCRS to *elective deferrals* refer to pre-tax deferrals. After-tax contributions are addressed separately with different correction procedures. The modified rules in Rev. Proc. 2015-28 refer to "Employee Elective Deferral Failures", and defines that term as "a failure to correctly implement *elective deferrals*…" so it would seem that the new rules only apply to missed pre-tax contributions. If that is so, does the 40% QNEC prescribed by EPCRS for missed after-tax contributions still apply? EPCRS originally prescribed a **lower** QNEC for missed after-tax contributions (40%) than the QNEC for missed pre-tax deferrals (50%). Under the new rules which only require a 25% QNEC for missed pre-tax deferrals, if the necessary QNEC for missed after-tax contributions is still 40%, then it is now **higher** than the QNEC for missed pre-tax deferrals.
- What is the correction for a missed deferral in a plan that uses automatic contribution features, but the failure extends beyond the 9 ½ month period after the end of the plan year of failure but not beyond the end of the second plan year? I have assumed that the new rule of a 25% QNEC would apply (?)
- EPCRS prescribes special treatment for missed catch-up contributions which effectively required a 25% QNEC. Should missed catch-up contributions be viewed as any other missed deferral under the new rules (i.e., no QNEC necessary if correction is made within a rolling 3 months period)?
- The new safe harbor in Rev. Proc. 2015-28 for adjusting required contributions for earnings states that the calculation cannot "result in a reduction in the required corrective contributions relating to any matching contributions." Does this stipulation to disregard negative earnings only relate to corrective match? Not to QNECs for missed deferrals?

I have compiled a chart of the various iterations that now exist for corrections of failed deferrals under the current EPCRS, incorporating the modified rules. *This is a work in progress, and I would be happy for any feedback or additions/corrections to the chart.*

Error	deferral correction	match correction	earnings adjustment	notice to employee*
Failure to provide opportunity to make pre-tax elective or designated Roth deferrals OR failure to implement an election on a timely basis.	**Employer must:**	match must be calculated under the terms of the plan as if the missed deferrals had been contributed to the plan.	based on rate applicable to employee's investment choices for the period of failure. Rate of return of fund with highest return rate made by used.	not required.
(this correction method will apply UNLESS one of the situations below is applicable)	make a QNEC equal to 50% of the missed deferral** plus earnings *(see NOTE at bottom with respect to Roth QNEC).* Must be deposited by the last day of the second plan year following the plan year of failure.	match and related earnings must be deposited by last day of second plan year following the plan year of failure.	If employee had no investment elections, earnings may be based on rate of return under plan as a whole.	

Error	deferral correction	match correction	earnings adjustment	notice to employee*
Failure to implement an automatic contribution feature - including employees who made affirmative elections in lieu of automatic contributions but whose elections were not implemented correctly.	If failure to implement the correction does not extend beyond 9 1/2 months after end of plan year of failure, NO QNEC required.	match must be calculated under the terms of the plan as if the missed deferrals had been contributed to the plan.	If employee has NOT made investment elections, earnings may be calculated based on the plan's default investment alternative. However, negative earnings may not result in a reduction of the matching contribution.	must be provided no later than 45 days after date on which correct deferrals begin.
Also, automatic escalation that was not implemented.				
	If failure to implement the correction extends beyond 9 1/2 months after end of plan year of failure (but not beyond last day of 2nd plan year), Employer must make QNEC of 25% of missed deferral** + earnings no later than last day of second plan year following plan year of failure.	match and related earnings must be deposited by last day of second plan year following the plan year of failure.	Alternatively, employer may use earnings adjustment methods set forth under EPCRS.	
	Employer must:			
	start deferrals by (i) last day of the 9 1/2 month period after end of plan year of failure **OR**, (ii) if employee notifies employer of the failure <u>sooner</u> than 9 1/2 months after end of plan year, deferrals must start by the first pay period on or after the last day of the month after the month of notification.			

Error	deferral correction	match correction	earnings adjustment	notice to employee*
SPECIAL RULE FOR BRIEF EXCLUSION Pre-tax, Roth, or after-tax deferral failures **that occur in first 3 months** of plan year.	NO QNEC required as long as employee is provided opportunity to make deferrals for a period of at least 9 months in plan year and has opportunity to defer the maximum amount that would have otherwise been permitted.	match must be calculated under the terms of the plan as if the missed deferrals had been contributed to the plan.	If employee has NOT made investment elections, earnings may be calculated based on the plan's default investment alternative. However, earnings on the related *match contribution* may not result in a reduction of the match.	NOT REQUIRED
2013-12 Appendix B Section 2 .02(1)(ii)(F)				
		match and related earnings must be deposited by last day of second plan year following the plan year of failure.	Alternatively, employer may use earnings adjustment methods set forth under EPCRS.	
Failure to implement a pre-tax or Roth deferral election OR failure to provide opportunity to make deferral election that **occurs past the first 3 months** of the plan year but does not exceed a total of 3 months and is unrelated to automatic contributions.	NO QNEC required	match must be calculated under the terms of the plan as if the missed deferrals had been contributed to the plan.	If employee has NOT made investment elections, earnings may be calculated based on the plan's default investment alternative. However, earnings on the related *match contribution* may not result in a reduction of the match.	must be provided no later than 45 days after date on which correct deferrals begin.
	Employer must:			
	correct deferrals no later than earlier of (i) first pay period on or after the 3-month period that begins after failure occurred or (ii) if employee notifies employer of the failure sooner, the first pay period on or after last day of the month after the month of notification.	match and related earnings must be deposited by last day of second plan year following the plan year of failure.	Alternatively, employer may use earnings adjustment methods set forth under EPCRS.	

Error	deferral correction	match correction	earnings adjustment	notice to employee*
Failure to implement a pre-tax or Roth deferral election OR failure to provide opportunity to make a deferral election that exceeds 3 months but does not go beyond the end of the second plan year following the plan year of failure, and is unrelated to automatic contributions.	QNEC equal to 25% of the missed deferral** + earnings must be deposited by last day of second plan year following plan year of failure.	match must be calculated under the terms of the plan as if the missed deferrals had been contributed to the plan.	If employee has NOT made investment elections, earnings may be calculated based on the plan's default investment alternative. However, negative earnings may not result in a reduction of the match contribution.	must be provided no later than 45 days after date on which correct deferrals begin.
	Employer must:			
	correct deferrals no later than earlier of (i) first pay period on or after last day of second plan year following plan year of failure or (ii) if employee notifies employer of the failure sooner, the first pay period on or after last day of the month after the month of notification.	match and related earnings must be deposited by last day of second plan year following the plan year of failure.	Alternatively, employer may use earnings adjustment methods set forth under EPCRS.	
Failure of employee to be able to elect after-tax contributions (other than Roth) OR failure by employer to implement an after-tax election on a timely basis.	**Employer must:**	match must be calculated under the terms of the plan as if the missed deferrals had been contributed to the plan.	based on rate applicable to employee's investment choices for the period of failure. Rate of return of fund with highest return rate made by used.	not required.
	make a QNEC equal to 40% of missed contributions** by last day of second plan year following plan year of failure.	match and related earnings must be deposited by last day of second plan year following the plan year of failure.	If employee had no investment elections, earnings may be based on rate of return under plan as a whole.	

Rev Proc 2015-28 is set to expire on 12/31/2020.
The Service will consider whether to extend the correction methods.

* Content of notice requirement: General information relating to the failure, such as % of compensation that should have been deferred and the date deferrals should have begun.
A statement that appropriate amounts have begun to be deducted and contributed or will begin shortly.
A statement that corrective contributions relating to missed match have been made or will be made.
An explanation that affected participants may increase their deferral percentage in order to make up for the lost deferrals, subject to limits under 402(g).
Name of plan and plan contact info, including name, street address, email address, and phone number.

** The missed deferral for an employee who filed an election is the elected deferral percentage multiplied by compensation, or the specified dollar amount, if applicable.
If the employee did not file an election:
The missed deferral for a plan that is NOT safe harbor is the ADP for the employee's group multiplied by his compensation. 2013-12 Appendix A .05(2)(b)
The missed deferral for a safe harbor plan is the greater of 3% of compensation or the maximum deferral percentage for which the employer provides a 100% safe harbor match. 2013-12 Appendix A .05(2)(d)(i)
The missed deferral for a plan that is safe harbor and uses an automatic contribution feature, and the failure does not extend past the last day of the first plan year beginning after the date of failure,
is equal to 3% of compensation.
The missed deferral for a plan that is safe harbor and uses an automatic contribution feature, and the failure extends past the last day of the first plan year beginning after the date of failure,
is equal to the qualified percentage specified in the plan. 2013-12 Appendix A .05(2)(d)(ii)
For after-tax (non-Roth) contributions, the missed contribution is the ACP for the employee's group multiplied by compensation (only counting the portion of the ACP attributable to after-tax contributions).
NOTE: no corrective contributions for missed deferrals may be treated as Roth contributions. 2013-12 Appendix A .05 (3)

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