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EPCRS Case Studies

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Correction Programs

- **IRS**
  - Rev. Proc. 2016-51 - Employee Plans Compliance Resolution System (“EPCRS”)
  - Rev. Proc. 2015-32 – Correction Program for Late Filers of Form 5500-EZ
- **DOL**
  - Voluntary Fiduciary Correction Program (“VFCP”)
  - Delinquent Filer Voluntary Compliance Program (“DFVCP”)

Types of Failures under EPCRS

- **Plan Document** – A plan provision (or absence of a provision) that violates the requirements of IRC § 401(a) or § 403(b) at face value. *Includes the failure to adopt required plan amendments and nonamender failures*
- **Operational** – Failure to follow the terms of the plan document
- **Demographic** – Failure to satisfy the requirements of § 401(a)(4), § 410(b), or § 401(a)(26) that is not an Operational or Employer Eligibility failure
- **Employer Eligibility** – Adoption of 401(k) plan by an employer who is not eligible to sponsor such a plan

EPCRS Correction Programs

- **Self Correction Program ("SCP")**
  - Available for **Operational Failures only**
  - Must have established practices and procedures
  - Only available to correct **significant** failures if plan has a determination letter (if individually designed) or an advisory/opinion letter (if pre-approved)
  - Insignificant failures may be corrected at any time
  - Significant failures must be corrected (or substantially corrected) by the last day of the second plan year following the plan year in which the error occurred
  - Whether a failure is "significant" or "insignificant" depends on all relevant facts and circumstances

EPCRS Correction Programs

- **Voluntary Correction Program (“VCP”)**
  - Available for correction of Plan Document, Operational, Demographic and Employer Eligibility failures
  - Must file under VCP to seek IRS approval
  - Filing fees apply
  - Certain failures must be made under VCP
    - Loan failures that violate the requirements of § 72(p)
    - Correction of late RMDs, if requesting a waiver of excise taxes
    - Operational failures being corrected by a retroactive amendment (except for limited situations)
    - Significant Operational failures made outside the correction period

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Effect of Examination

- VCP is not available if the plan or Plan Sponsor is under examination
- SCP is available while the plan or Plan Sponsor is under examination:
  - For insignificant failures that can otherwise be corrected under SCP
  - For significant failures if the corrections have been completed (or substantially completed) before the examination

EPCRS Correction Programs

- Audit Cap Program
  - Available when a plan or Plan Sponsor is under examination
  - May be used to correct failures not previously corrected under SCP or VCP
  - IRS may allow the Plan Sponsor to make corrections for insignificant failures under SCP
  - IRS will impose sanctions
  - Much more costly than SCP or VCP
  - Encourages employers to discover and correct failures quickly

EPCRS Basic Principles

- The correction should place the plan and participants in the same position they would have been had the error not occurred
- In general, corrections must be made for all plan years
- The correction should be reasonable and appropriate
- Related earnings should be considered through the date of the correction
- Corrections methods provided under Rev. Proc. 2016-51 are deemed reasonable
- The correction should generally keep assets in the plan
- The correction method should be consistently applied
- Reasonable estimates may be used in certain situations
- There are exceptions for certain (limited) situations
  - Delivery of small benefits - $75
  - Recovery of small overpayments - $100
  - Small excess amounts - $100

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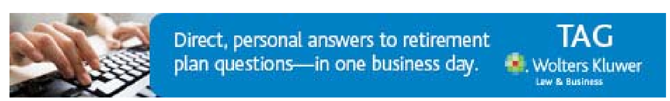
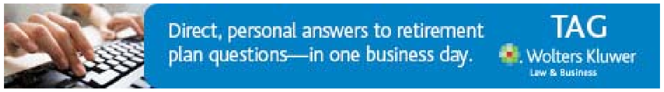


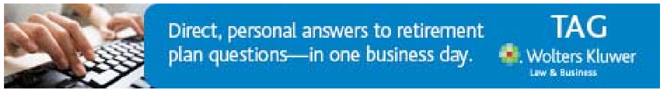
TAG Frequently Asked Questions

EPCRS



Case Study #1 - Fact Pattern

- 401(k) Plan
- Employer mistakenly allowed an active employee to take a full termination distribution
- Distribution was made in February 2017
- Distributed funds were rolled to an IRA
- Employee will terminate in November 2017



Case Study #1 – The Question

"What is the proper correction for this error, and does the fact that he will be terminated in November make any difference in the correction method?"

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Case Study #1 – The Answer

- The employer should take reasonable steps to have the overpayment, adjusted for related earnings, returned by the participant to the plan.
- If the participant refuses, the employer (or another person) must contribute the amount, adjusted for earnings, to the plan.
- The participant must also be notified that the amount was not eligible for rollover.

Case Study #1 – The Answer

- Even though it seems this error will "self-correct", the issue is that the distribution was not eligible for rollover at the time made.
- From Rev. Proc. 2016-51:

  "the employer must notify the employee that the Overpayment was not eligible for favorable tax treatment accorded to distributions from an eligible retirement plan under §402(c)(8)(B) (and, specifically, was not eligible for tax-free rollover)"

Case Study #2 - Fact Pattern

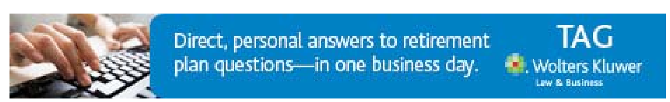
- Participant received a 2016 RMD
- Participant is not a "5% owner" and is actively employed
- Plan does not require RMDs for active participants who are not "5% owners"
- Plan does not permit in-service distributions

Case Study #2 – The Question

"If a participant receives a Required Minimum Distribution in error in the prior year, do future RMDs need to continue to be processed?"

Case Study #2 – The Answer

- No. If the participant is not required to receive RMDs under the terms of the plan, the plan should not be paying RMDs just because the plan made an error in a prior year.
- Rather, the plan needs to address the operational error that occurred (i.e. failure to follow the terms of the plan document).



Case Study #2 – The Answer

- In general, the correction is for the overpayment to be returned to the plan by the participant, adjusted at the plan's earnings rate.
- There is an exception to this repayment rule, however, when the distribution would have otherwise permissible under the Code/regulations if allowed under the plan (which would seem to apply in this particular situation).

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Case Study #2 – The Answer

- **From Rev. Proc. 2016-51:**

  "Make-whole contribution. To the extent the amount of an Overpayment adjusted for Earnings at the plan's earnings rate is not repaid to the plan, the employer or another person must contribute the difference to the plan. The preceding sentence does not apply when the failure arose solely because a payment was made from the plan to a participant or beneficiary in the absence of a distributable event (but was otherwise determined in accordance with the terms of the plan (e.g. an impermissible in-service distribution))."

Case Study #3 - Fact Pattern

- Employer paid a terminated participant $1,500 more than she was entitled to receive
- The employer does not want to recoup the money from the participant
- They would prefer to make the plan whole through the corporation by writing a check and depositing it to the plan trust

Case Study #3 – The Question

"Is it acceptable for the employer to make the plan whole and not seek repayment from the former employee? Any other considerations?"

Case Study #3 – The Answer

- Yes, the employer can make the plan whole without seeking repayment from the participant.
- Rev. Proc. 2016-51 provides:

  "Other appropriate correction methods may be used to correct Overpayment failures from a defined contribution plan. Depending on the nature of the Overpayment, an appropriate correction method may include using rules similar to the correction method in section 6.06(4)(a) but having the employer or another person contribute the amount of the Overpayment (with appropriate interest) to the plan instead of seeking recoupment from a plan participant…"

Case Study #3 – The Answer

- The participant still must be notified the amount distributed in error was NOT eligible for rollover
- The overpayment (plus related earnings) must be placed in an unallocated account
  - Used to reduce employer contributions (in the current or succeeding year), or
  - If the amount would have been allocated in the year of the failure, then it must be reallocated in accordance with the terms of the plan

Case Study #4 - Fact Pattern

- 401(k) Plan
- Plan Sponsor allowed a participant (NHCE) to make Roth contributions
- Plan does not permit Roth contributions
- This has been going on for over 2 years

Case Study #4 – The Question

"I don't believe a retroactive amendment is allowable. What are their options?"

Case Study #4 – The Answer

- There is no specific guidance for this particular failure
- In general, it is permissible to retroactively amend a plan under VCP to conform its terms to how the plan was operated (i.e. to add the Roth provision retroactively)
- This type of correction could not be made under SCP, though

Case Study #4 – The Answer

- Retroactive amendments under SCP are only available for:
  - Section § 401(a)(17) failures (to provide an additional contribution to eligible employees)
  - Certain hardship and plan loan failures (to permit hardship distributions and loans retroactively)
  - Early inclusion of an otherwise eligible employee (to make them eligible retroactively)
  - **No other retroactive amendments are permissible under SCP**

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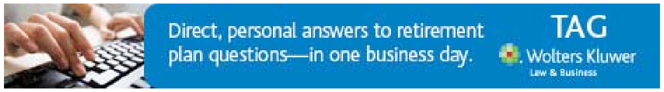
Case Study #5 - Fact Pattern

- One ineligible employee (never has worked 1,000 hours) was allowed to start deferring in a 401(k) beginning in December 2014
- The employee has continued to be allowed to defer since that time
- We are suggesting a retroactive amendment to the VS prototype document to correct the operational error under SCP



Case Study #5 – The Question

"Can the employee be named in the amendment so as to not affect other employees for eligibility purposes?"

Case Study #5 – The Answer

- Yes, the plan can be amended with respect to only the employee who was allowed to participate early (i.e. by name)
- Rev. Proc. 2016-51 provides that:

  "The amendment may change the eligibility or entry date provisions with respect to only those ineligible employees that were wrongly included, and only to those ineligible employees, provided (i) the amendment satisfies §401(a) at the time it is adopted, (ii) the amendment would have satisfied §401(a) had the amendment been adopted at the earlier time when it is effective, and (iii) the employees affected by the amendment are predominantly nonhighly compensated employees."

Case Study #6 - Fact Pattern

- An employee from an excluded class was allowed to participate in the plan for all purposes (401(k), match and profit share)
- This error occurred over 4 years
- Plan sponsor wants to amend the plan retroactively to correct this mistake

Case Study #6 – The Question

"What is the correction under EPCRS? The plan sponsor would like to amend the plan retroactively."

Case Study #6 – The Answer

- A retroactive amendment is permissible, provided the employee is not highly compensated
- Correction should be made under VCP
- Retroactive amendments can only be made under SCP for limited situations, and this isn't one of them

Case Study #6 – The Answer

- From Rev. Proc. 2016-51, Appendix B, Sec. 2.07(3)(a):

  "The Operational Failure of including an otherwise eligible employee in the plan who either (i) has not completed the plan's minimum age or service requirements, or (ii) has completed the plan's minimum age or service requirements but became a participant in the plan on a date earlier than the applicable plan entry date, may be corrected by using the plan amendment correction method set forth in this paragraph."

Case Study #7 - Fact Pattern

- 401(k) Plan with age 21 and year of service requirement
- Dual entry dates (January 1 and July 1)
- Plan sponsor let an employee participate before they were eligible
- Employee became eligible January 1, 2017 but made deferrals in 2016

Case Study #7 – The Question

"What should be returned for self correction, deferrals and interest with a 2017 taxable 1099-R?"

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Case Study #7 – The Answer

- The general correction method under Rev. Proc. 2016-51 is for the plan to be amended retroactively to conform the terms of the plan to how it was operated, provided the amendment predominately impacts NHCEs
- The IRS has also indicated in EPCRS phone forums that ineligible deferrals may be distributed under the general correction principles of EPCRS

Case Study #7 – The Answer

- Deferrals, plus related earnings, would be distributed and any related match would be forfeited
- The distribution would be reported as taxable on a 2017 Form 1099-R using Code E -Distributions under Employee Plans Compliance Resolution System (EPCRS)

Case Study #7 – The Answer

- In a 2013 IRS Phone Forum, the IRS suggested that making a correction in this manner might require the participant to file an amended individual tax return (implying the amount would be taxable for 2016)
- It is unclear how this informal IRS guidance could be applied
- Since the distribution is being made in 2017, it should be reported on a 2017 Form 1099-R (regardless of the fact that it relates to deferrals made in 2016)
- Code E should be used to report the distribution and there is no code that could be used to indicate the distribution should be taxable for the prior year
- It seems the only option would be to report it as taxable in the year of the distribution

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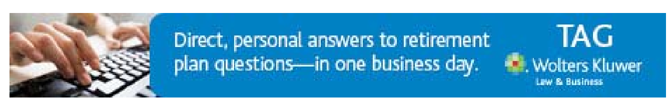


Case Study #8 - Fact Pattern

- Safe harbor match effective January 1, 2011
- Safe harbor match allocated on a plan year basis (2011 through 2016)
- Employer calculated SH match on a payroll period basis and never made “true-up” contributions
- Safe harbor notices for all plan years indicated matching contributions would be calculated on a payroll period basis

Case Study #8 – The Question

"Can the amendment be viewed as a "typo", or can a corrective amendment be done back to 2011 to conform the document to agree with the operation of the plan?"

Case Study #8 – The Answer

- No; amending the plan retroactively would violate IRC § 411(d)(6)
- Rev. Proc. 2016-51 provides that retroactive amendments must comply *"with the applicable Code requirements, including, for a Qualified Plan, § 401(a) (including the requirements of §§ 401(a)(4), 410(b), and 411(d)(6))."*

Case Study #8 – The Answer

- The plan and participants must be placed in the same position they would have been had the error not occurred
- The employer must determine what matching contributions should have been under the plan's allocation formula (i.e. plan year basis)
- The employer must make a corrective contribution for any safe harbor matching contributions due, along with related earnings

Case Study #9 - Fact Pattern

- An employee was not given the opportunity to defer in 2015
- The plan sponsor is making a QNEC of 1.5% (25% of missed deferral)
- The “missed deferral” was 6% (the ADP for the NHCEs)
- Plan is top-heavy
- Participant is entitled to the 3% top-heavy minimum contribution

Case Study #9 – The Question

"Can the QNEC be used towards satisfying the top-heavy minimum contribution requirement? "

Case Study #9 – The Answer

- Unclear; but we think the answer is no
- QNECs generally may be considered for top-heavy minimum purposes
- However, if the employee had been allowed to defer, he or she would still have been entitled to the top-heavy minimum contribution

Case Study #10 - Fact Pattern

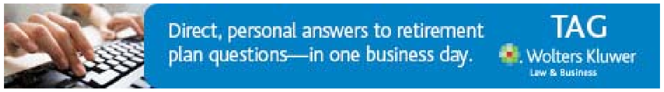
- Beth was hired on October 7, 2014
- Her scheduled entry date was January 1, 2016
- Beth's rollover contribution was processed on December 31, 2015
- The plan does not allow employees who are not yet eligible to make rollover contributions

Case Study #10 – The Question

"Beth's rollover should not have been processed on December 31st since she was not eligible until January 1st, right?"

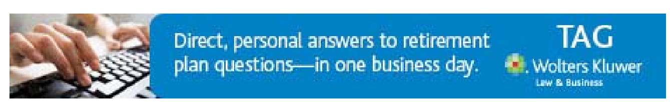
Case Study #10 – The Answer

- Technically, this was an operational failure (i.e. failure to follow the terms of the plan) since the rollover was credited to her account prior to her entry date
- Presumably, corrections are not necessary with respect to the rollover contribution
- Both the plan and participant are now in the same position they would have been had the error not occurred
- But…the plan sponsor should make sure procedures are in place to prevent this type of error from occurring in the future



Case Study #11 - Fact Pattern

- Excess contribution under 402(g) in a single plan
- EPCRS section 6.02(5)(b) provides that "If the total corrective distribution due a participant or beneficiary is $75 or less, the Plan Sponsor is not required to make the corrective distribution if the reasonable direct costs of processing and delivering the distribution to the participant or beneficiary would exceed the amount of the distribution."



Case Study #11 – The Questions

"Is a 402(g) excess of less than $1 considered a small benefit that would not be required to be distributed if the costs of processing the distribution excess the amount of the distribution?"

"If so, could 402(g) excesses of up to $75 be considered a small benefit that would not need to be distributed if the cost of processing the distribution is $75?"

Case Study #11 – The Answer

- Not quite. A 402(g) excess is an "Excess Amount" as defined under Rev. Proc. 2016-51.
- There is an exception that may apply in this particular situation; however, it is not found under Section 6.02(5)(b).
- Section 6.02(5)(e) applies which provides that…

  "if the total amount of an Excess Amount with respect to the benefit of a participant or beneficiary is $100 or less, the Plan Sponsor is not required to distribute or forfeit such Excess Amount. However, if the Excess Amount exceeds a statutory limit, the participant or beneficiary must be notified that the Excess Amount, including any investment gains, is not eligible for favorable tax treatment accorded to distributions from the plan (and, specifically, is not eligible for tax-free rollover)."

Case Study #11 – The Answer

- Regardless of whether the 402(g) excess is $100 or less, the plan sponsor will want to consider the recordkeeping issues that would be required if the plan were to rely on this exception **(i.e. tracking the excess amount on an ongoing basis, along with related earnings, so that the amount could be reported properly when distributed from the plan at a later date).**

Case Study #12 - Fact Pattern

- 401(k) profit sharing plan
- Plan was not amended for EGTRRA or PPA

Case Study #12 – The Questions

"What documents must be submitted with the VCP filing?"

"What is the fee for the VCP filing; do 2 fees apply?"

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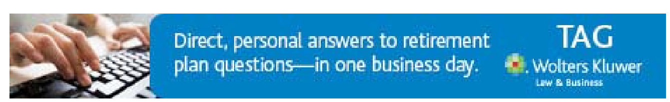
Case Study #12 – The Answer

- The submission must include the EGTRRA restatement, all required interim amendments, and the PPA restatement
- A single VCP fee applies, even though the filling will include more than one required restatement



Case Study #13 - Fact Pattern

- A participant had an account balance as of January 1, 2016 of $6,750 (with a loan balance of $450)
- The assets are held in a pooled account that is valued annually
- During 2016, the unpaid loan of $450 was paid in full and a new loan was processed for $4,750
- At no time, was the account balance of the participant at least $9,500 to support this new loan amount
- However, as of December 31, 2016, the participant's balance in the plan was $7,100 with a loan balance of $3,430

Case Study #13 – The Question

"Is there an issue with the loan and if so, what correction is needed?"

Case Study #13 – The Answer

- Yes, since the loan exceeded the maximum amount available when made, the excess was taxable to the participant at that time (i.e. in 2016)
- The only way to correct this would be to file under VCP
- Rev. Proc. 2016-51 permits a corrective repayment based on the excess of the loan over the maximum amount
- Loan payments that have been made may be taken into consideration

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Case Study #13 – The Answer

- After the corrective payment has been made, the loan may be "reformed" to amortize the remaining balance over the remaining term of the loan
- Rev. Proc. 2016-51 requires a *"specific request for relief…be made if the applicant either wants relief from reporting a corrected participant loan as a deemed distribution or wants to report the loan as a deemed distribution in the year of correction instead of the year in which the deemed distribution occurred".*

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Case Study #14 - Fact Pattern

- Participant was 78 in 2016
- He retired on December 31, 2016
- We were not notified of his retirement until late April of 2017

Case Study #14 – The Question

"Is the participant required to start taking RMDs for 2016 or would his first RMD be in 2017?"

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Case Study #14 – The Answer

- Since the participant retired in 2016, his Required Beginning Date was April 1, 2017 (for his 2016 RMD)
- His 2016 RMD is now late
- The plan has an operational failure (i.e. failure to follow the terms of the plan) that must be corrected
- Rev. Proc. 2016-51 allows the failure to be corrected by issuing the missed RMD (along with related earnings) to the participant

Case Study #14 – The Answer

- There are two options for requesting a waiver of the 50% excise tax applicable to late RMDs
  - The participant may request the waiver on Form 5329, or
  - The plan may request the waiver through VCP. As provided for under Rev. Proc. 2016-51, *"the Plan Sponsor, as part of the submission, must request the waiver…"*

Case Study #15 - Fact Pattern

- 401(k) plan
- Participant took a hardship distribution on January 2, 2017
- The employer did not suspend deferrals
- The employee never stopped deferring and the six-month suspension period is now over

Case Study #15 – The Question

"What is the correction?"

Case Study #15 – The Answer

- Rev Proc 2016-51 does not include or reference this particular failure, and therefore does not provide a specific correction method
- Rev Proc 2016-51 does provide a correction method for a contribution which is an “Excess Amount”
- Specifically, Rev Proc 2016-51 provides that a deferral which is an “Excess Amount” is corrected through a distribution
  - An “Excess Amount” is a contribution that exceeds a plan or statutory limit. A failure to suspend deferrals following a hardship distribution does not quite fit the definition, but it is close

Case Study #15 – The Answer

- One option may be to issue a distribution to the participant for the ineligible deferrals
  - If this approach were taken, related earnings would need to be taken into consideration, and related matching contributions would need to be forfeited
  - Note that such a corrective distribution would not be an eligible rollover distribution
- Also, the IRS has posted (informal) guidance on their website indicating that it may be possible to correct this error by:
  - Suspending deferrals for the next 6 months, or
  - Having the participant return the hardship distribution, adjusted for earnings, to the plan

Case Study #15 – The Answer

https://www.irs.gov/retirement-plans/correct-common-hardship-distribution-errors

Correct Common Hardship Distribution Errors

- **Option 1 - Suspend the employee from making salary deferrals for a six month period going forward**. However, this may not put the participant in the same position as they would've been if you suspended their contributions immediately after receiving the hardship distribution. For example, the plan's matching contribution levels for the six month period going forward could be different than what they were during the correct suspension period.
- **Option 2- Return the hardship distribution.** The employee could return the hardship distribution (adjusted for earnings) to the plan. This could put the employee in the same position she would've been in had the failure not occurred. This approach may not be a viable solution because the affected employee may not have sufficient resources to repay a hardship distribution. **Note, the plan sponsor can't address a failure to suspend salary deferrals by simply revising administrative procedures going forward because this option wouldn't correct the failure to suspend elective deferrals in the past.**

For More Information

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