
Update on IRS and DOL Correction Programs

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Employee Benefits Academy
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Presentation by:
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Kelly practices in the tax group with a concentration in the area of executive compensation and employee benefits.

She has worked with both public and private companies on an array of employee benefit matters, focusing on qualified retirement plans, health and welfare plans and executive compensation arrangements. Her experience includes helping clients navigate and comply with the complex and numerous legal requirements associated with the administration of equity compensation and employee benefit plans and advising companies on fiduciary duties with respect to qualified retirement plans.

She works with entities on all stages of benefit plan matters, including advising companies on the design and implementation of new plans, drafting documents, counseling companies on the maintenance and correction of plans and finally, assisting in merging or termination of plans. She is experienced in design and implementation of employee stock ownership plans (ESOPs) as well as ESOP transactions.

Upcoming 2021 Webinars

- **Upcoming 2021 webinars:**
 - **September 23:** Self-Directed IRAs and investments relating to the same
 - **October 28:** Navigating controlled group and affiliated service group rules
 - **November 18:** Year-End Benefit Plan Requirements/End of Year Benefits "To Do" List
 - **December 16:** Benefits Year in Review and a Look Ahead to the Upcoming Year
- Sign up here: [Employee Benefits Academy Webinar Series - Subscribe](#)

- Overview of IRS Correction Programs
 - Self Correction Program (SCP)
 - Voluntary Correction Program with IRS Approval (VCP)
 - Audit Closing Agreement Program (Audit CAP)
- Discussion on most common failures & correction methods
- Overview of recent changes in Revenue Procedure 2021-30
- Overview of DOL Correction Programs
 - Voluntary Fiduciary Correction Program
 - Voluntary Delinquent Filer Correction Program

IRS Correction Program Overview

- Employee Plans Compliance Resolution System (EPCRS)
 - EPCRS identifies and prescribes certain required correction methods for specific failures
- Encourages plan sponsors to correct various types of qualified employee benefit plan errors through self-correction, voluntary submissions to the IRS (VCP), and in the audit process.
- EPCRS has been around since 2006; IRS keeps updating and expanding the program through issuance of Revenue Procedures
- On July 19, 2021, IRS released Rev. Proc. 2021-31; which modified and superseded Rev. Proc. 2019-19

EPCRS – Overview con't and Categorizes types of Failures

- Qualified Plans must at all times, meet the applicable Code provisions. If it does not, then, technically, the qualified plan is considered “unqualified” and taxable. IRS provides EPCRS to provide plan sponsors guidance on how to correct failures and return the plan back to qualified status.
- Qualification Failures - Any failure that adversely affects the qualification of the Plan
 - Plan Document Failure
 - Operational Failure
 - Demographic Failure
 - Employer Eligibility Failure

- Plan Document Failure - Plan provision (or absence of a plan provision) that, on its face, violates IRC 401(a) or 403(a).
 - Example: Failure to adopt a required plan amendment during the remedial amendment period.
- Demographic Failure - Failure to meet nondiscrimination or coverage requirements of IRC 401(a)(4), 410(b) or 401(a)(26); usually requires a corrective plan amendment to add or increase benefits.
 - Example: Plan failed 410(b) coverage over period of time due to adding new control group entity and failing to include in coverage test.

EPCRS – Categorizes types of Failures (con't)

- Employer Eligibility Failure - Attempt to adopt 401(k) plan by employer which fails to meet the employer eligibility requirements.
 - Example: Non-tax exempt entity adopts a 403(b) plan.
- Operational Failure - Qualification failure (jeopardizes plan's qualified status) caused solely by a failure to follow plan provisions
 - Probably the most common failure
 - Example: Plan's compensation definition includes bonuses and Plan failed to include bonuses for salary deferrals and profit-sharing contributions.

Plans that can use EPCRS

- Qualified 401(a) Plans such as:
 - 401(k) Plans
 - ESOPs
 - Defined Benefit Plan
- 403(b) Plans
- SEPs
- Simple IRA Plans
- SARSEPs
- Governmental 401(a) and 403(b) plans

- There are three programs identified in EPCRS:
 - Self-Correction Program – No IRS approval, Plan Sponsor corrects on its own
 - Self-Correction Program is limited to only certain categories of failures
 - Voluntary Correction Program – Requires IRS approval
 - Must file a “VCP application” with the IRS with identified failures and correction methods
 - IRS must approve the correction method
 - Audit CAP
 - IRS identifies the failure – typically through audit or determination letter submissions
 - IRS imposes fine on Plan Sponsor based on failure

Self Correction General Principles

- Available for Operational Failures and some Plan Document failures
- Operational Failures are grouped as either “significant” or “insignificant”
 - Significant vs. insignificant based on facts and circumstances
 - E.g., amount of plan assets involved, numbers of participants, numbers and severity of failures, number of years involved, etc.
 - Correction of significant failure must be substantially completed by last day of the **third*** plan year following the plan year in which the failure occurred; period extended in case of corporate transaction
- Favorable determination letter required for significant failure

*Most recent EPCRS extended this from second plan year to third plan year

Self Correction General Principles

- For plans under examination, may correct insignificant failures, and complete correction of significant failures already started
- Must have established practices and procedures reasonably designed to promote overall compliance
- Limited ability to correct by plan amendment

Self Correction General Principles

- Correction by Plan Amendment con't:
 - Certain Operational Failures can be corrected by plan amendment if the following are met:
 - The corrective amendment results in an increase of a participant's benefit, right or feature under the Plan
 - The increase in the benefit, right or feature was permitted under the Code and satisfies the correction principles (described later) of EPCRS and any other applicable rules in EPCRS
 - And, before Rev. Proc. 2021-30: additional requirement to correct failure by plan amendment:
 - The increase in benefit, right or feature is provided to all employees eligible to participate in the plan (this requirement significantly reduced the ability to self-correct by plan amendment)

VCP General Requirements

- Plan cannot be “Under Examination”
- VCP does not preclude IRS examination of plan; however, plan will not normally be examined while VCP is pending
- Online Application is required describing, among other things, the failure and the proposed (or completed) correction. Detailed information requirements and documents for VCP submission provided in Rev. Proc. 2021-31
- Filing fee – Based on amount of plan assets:
 - \$1,500 for Plan with assets \$0-\$500,000
 - \$3,000 for Plan with assets \$500,001-\$10 million
 - \$3,500 for Plan with assets over \$10 million

- Compliance statement issued by IRS addresses the failure and agreed upon correction. IRS will not treat plan as failing the applicable Code requirements if the corrections are timely made
 - Corrections must be implemented within 150 days of issuance of compliance statement

Audit CAP General Requirements

- Available to correct failures (not previously corrected under SPC or VCP) identified by IRS during examination
- Sanction is a negotiated percentage of the Maximum Payment Amount (*i.e.*, the tax that could be collected upon plan disqualification)
 - Sanction should not be excessive and to bear reasonable relationship to nature, extent and severity of failures
- Failure to reach agreement on failures, correction or sanction will result in plan disqualification

- These correction principles apply to all three correction programs
- Should fully correct the failure, regardless of how long and how much (some exceptions to full correction)
- Must restore the plan to the position it would have been in had the failure not occurred (including restoration of participant benefits)
- Correction method must be reasonable and appropriate for the failure

- For nondiscrimination failures, correction should provide benefits to NHCEs
- Correction should try to keep plan assets in the plan
- Correction should not violate provisions of the Code (*e.g.*, anti-cutback requirements of 411(d)(6))
- Consistent correction method should be used for correcting same type of failure for same plan year
- If not specifically covered by EPCRS, it should resemble a correction already in the Code (*e.g.*, refunding pre-tax contributions over the 402(g) limit)

Rules for corrective allocations and distributions:

- Correction should be based on terms of plan at time of failure
- Should be adjusted for earnings (potentially including losses) and forfeitures that would have been allocated to participant's account
- Considered an annual addition for the year to which the correction relates (year of the failure), not the year that the corrective allocation is made
- Corrective allocations should come only from employer contributions
- Corrective distribution from defined benefit plan should be adjusted for delayed payment consistent with plan's actuarial assumptions

Special exceptions to full correction

- Reasonable estimates may be used if precise calculation is not possible, or difference in precise calculation and estimate is insignificant and administrative costs would exceed the difference
- Corrective distribution of \$50 or less is not required
- Overpayment of \$250 or less does not require recovery from participant*

*updated this year from \$100

Overpayments from Plan (also referred to as Excess Amounts)

- Defined Contribution Plans
 - Can correct by adopting a plan amendment (not common)
 - Plan sponsor must take “reasonable steps” to have the overpayment returned to the plan:
 - Plan sponsor or another person can contribute the overpayment amount (with earnings) to the plan instead of seeking recoupment from the individual
 - See next slide for notification/tax treatment
- Defined Benefit Plans
 - If annuity payments, can reduce the future payments to recoup amounts
 - Plan sponsor or another person can contribute the overpayment amount (with earnings) to the plan instead of seeking recoupment from the individual
 - Two new options under updated EPCRS (discuss later)

Specific Correction Methods

Overpayments from Plan (con't)

- Tax Reporting:
 - Distribution of excess amount not eligible for rollover or other favorable tax treatment
 - Reported on Form 1099-R for year of distribution
 - Must notify recipient of excess amount and distribution, and that distribution is not eligible for favorable tax treatment

Failure to implement participant deferral elections or begin participation

- Correction depends on length of failure:
 - Failure less than 3 months: No employer corrective contribution for missed elective deferrals if the following are satisfied:
 - Correct deferrals begin on the payroll beginning on or after last day of 3 month period from beginning of failure
 - Required notice is given within 45 days after correct deferrals begin
 - If affected participant would be entitled to additional matching contributions, plan sponsor must make full matching contributions (adjusted for earnings) within SCP significant operational failure time frame.
 - Failure more than 3 months but shorter than SCP significant operational failure timeframe: Plan sponsor contributes 25% of missed elective deferrals if the following are satisfied:
 - Correct deferrals begin on the payroll beginning on or after last day of 3rd plan year following plan year of failure
 - Required notice is given within 45 days after correct deferrals begin
 - If affected participant would be entitled to additional matching contributions, plan sponsor must make full matching contributions (adjusted for earnings) within SCP significant operational failure time frame.

Specific Correction Methods, con't

Failure to auto-enroll participants

- If failure to implement auto-enroll is less than 9 months following the plan year in which the failure started, no employer contribution for missed elective deferrals is required if the following conditions are met:
 - Begin the auto-enrollment before the first payroll on or after the last day of the 9 month period following the plan year in which the failure first occurred for the affected employee
 - Must provide required notice within 45 days after the date auto-enrollment started
 - If affected participant would have been entitled to matching contributions, plan sponsor must make full matching contributions (with earnings based on the plan's default investment earnings, provided the default investment didn't have a cumulative loss) to the plan.

Failure to auto-enroll or implement participant deferral elections or begin participation

- If none of the conditions described in prior slides apply, then plan sponsor must make a QNEC equal to 50% of the missed deferral opportunity to the Plan, plus 100% of any missed matching contributions
- Missed deferral opportunity:
 - If failure to implement specific salary deferral election – use the directed salary deferral amount
 - If failure to implement auto-enrollment – use the auto-enrollment amount
 - If failure to offer opportunity to participate in non-safe harbor plan – use the ADP of the applicable group (either HCE or non-HCE)
 - If failure to offer opportunity to participate in safe-harbor matching contribution plan – missed deferral is deemed equal to the greater of 3% of compensation or the maximum deferral percentage for which the employer provides a matching contribution rate that is at least as favorable as 100% of the deferral
 - If failure to offer opportunity to participate in safe-harbor non-elective contribution plan – 3% of compensation

Required Notice Contents for correction of missed deferrals/auto-enrollment:

- General info regarding failure, such as percentage deferral and approximate date contributions should have started
- Statement that amounts have begun (or will begin) to be deducted from compensation and contributed to the plan
- Statement that corrective allocations relating to missed matching contributions have been made or will be made
- Explanation that affected participant may increase his or her deferral percentage to make up missed opportunity, subject to applicable limits under Code section 402(g)
- Name of plan and plan contact information (including name, address, email and phone number)

Common Mistakes – Compensation definition and failure to include/exclude certain payments

Plan's definition of Compensation used incorrectly for salary deferrals or company contributions:

- Failure to Include a type of Compensation (under reporting of compensation):
 - Calculate reduced contributions to the Plan due to under inclusion of Compensation
 - Include earnings
 - QNEC contribution to the plan
- Included a type of Compensation that was excluded (over reporting of compensation):
 - May be able to retroactively amend plan to include type of compensation (see SCP discussion)
 - Calculate over-contributions to the Plan
 - May or may not include earnings (depending on population)
 - Distribute over contributed salary contributions; forfeit company contributions

Common Failures – Incorrect Company Contributions

- Underpayment/allocation of Company Contributions:
 - Determine the correct allocation of Company Contributions
 - Incorporate Earnings into Company Contributions
- Overpayment/allocation of Company Contributions:
 - See Excess Amounts discussion for payments
 - If amounts are still in Plan:
 - Can forfeit amounts (with or without earnings) into forfeiture account in Plan
 - May consider adopting amendment to reflect increased Company Contributions – but need to make sure it doesn't trigger any nondiscrimination issues if not applicable to all participants (or non-highly compensated employees)

Common Failures – Fail to timely update Plan document

- Legally Required Changes
 - Did not update the Plan document for required legal changes
 - Required VCP
 - Adopt amendment for legal changes
- Discretionary Changes
 - Failure to timely adopt a discretionary amendment
 - Any discretionary change to your plan should be adopted within the same Plan Year as implemented
 - May be eligible for SCP (see prior discussion)
 - Adopt discretionary amendment and if not eligible for SCP, file a VCP application with IRS

Operational Failure

- Must put the Plan back in the place as if the failure never occurred
 - Two ways to do this:
 - Go back and fix the operational failure to reflect the terms of the Plan
 - Can be corrected via Self Correction if you meet the Self-Correction requirements
 - Retroactively amend the Plan to have the terms of the Plan reflect operation
 - Limited ability to do this under Self Correction
 - Cannot “cut-back” benefits or reduce benefits
 - Specific correction depends on the specific failure

Common Failures – Failed ADP or nondiscrimination tests and failed to timely correct

- ADP/ACP test failures
 - EPCRS has specific corrections that must be followed
 - EPCRS provides a few correction options for this failure
- Other Nondiscrimination failures
 - Generally run test and correct same as annual failure corrections
 - Likely will need to calculate earnings

- Anytime amounts allocated/paid to participants are over or under the correct amount, the IRS general requires calculation of earnings:
 - If correction requires reduction of account and failure generally impacts non-highly compensated employees, no earnings calculation is required
 - If correction requires increased amount, earnings calculation for defined benefit plans typically use plan's interest rate

- Several methods for calculating earnings for underpayment:
 - Participant Directed Plans:
 - Use Participant's actual earnings during period of failure based on investments in the Plan
 - Alternative to using participant's own investment earnings:
 - If affected group is predominantly non-highly compensated employees – can use the earnings rate in the Plan's investment line up with the highest rate of return during the period of failure
 - Can use the DOL's Online Calculator only if:
 - It is possible to calculate earnings, but the probable difference between the actual earnings and Online Calculator is insignificant and administrative cost of actual calculation would significantly exceed the probable difference OR
 - It is not possible to calculate actual earnings for the affected participants

New changes to IRS's correction program

- Eliminated “anonymous” VCP applications
- Added a free and anonymous pre-submission conference to discuss with IRS about a proposed correction before filing VCP
 - For proposed correction methods that are not specifically addressed in Rev. Proc. 2021-30
 - Plan Sponsor must be eligible for VCP and intends on submitting a VCP application
- Expanded period of significant operational failures for self correction from last day of 2nd plan year following year of failure to last day of 3rd plan year

New changes to IRS's correction program, con't

- Expanded option for participant choose to repay overpayment to DC plan through installment payments
- New options for recoupment of overpayments for defined benefit plans:
 - Generally, plans must either ask participant to repay overpayment amount or can make a contribution to the Plan instead of asking payment from participant.
 - Now, DB plans have 2 new options for overpayment:
 - Funding Exception Method: No corrective payment is required if the certified or presumed AFTAP is 100%.
 - Contribution Credit Method: Corrective payment is reduced by:
 - Cumulative increase in plan's minimum funding contribution by the overpayment amount and
 - Any additional contributions in excess of the minimum funding amount after overpayment

Short discussion on DOL's correction programs

DOL has 2 correction programs:

- **Delinquent Filer Voluntary Compliance Program:**
 - Allows Plan Sponsors to avoid significant IRS and DOL fees due to filing annual Form 5500 late or incomplete
 - Plan Sponsors are eligible for Program unless they have received a letter by the DOL notifying them of their late Form 5500 filing
 - Have to pay fee for filing, significantly cheaper than potential fees
 - Fees are based on whether Plan is large or small and whether multiple years are involved

Short Discussion on DOL's correction program

- Voluntary Fiduciary Correction Program (“VFCP”)
 - No fee
 - Allows plan sponsors to avoid higher civil penalty assessments by DOL due to a prohibited transaction or breach of fiduciary duty
 - If certain conditions are met, the program allows Plan Sponsors to avoid filing Form 5330 with IRS to report and pay excise taxes.
 - The most common filing under this program is delinquent contributions under the Plan
 - DOL’s VFCP program states that you cannot use the DOL’s Online Calculator to calculate earnings for the delinquent contributions unless you file a VFCP application
 - Otherwise, earnings calculations must be based on either actual earnings for the participant or highest rate of return for investment option during period.

Next Month's Webinars

Executive Compensation Academy

- Title: Preparing for Proxy Season: Start Now (Annual Program)
- When: September 9, 2021
- Time: 10:00 am – 11:00 am CT
11:00 am – 12:00 pm ET

Employee Benefits Academy

- Title: Self-Directed IRAs and investments relating to the same
- When: September 23, 2021
- Time: 10:00 am – 11:00 am CT
11:00 am – 12:00 pm ET

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