



Chapter 6

## IRS Voluntary Compliance Programs (EPCRS) For Tax-Qualified Retirement Plans

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Various IRS voluntary compliance programs were consolidated by the IRS in Rev. Proc. 98-22 into a coordinated program called the **Employee Plans Compliance Resolution System (EPCRS)**.

- Rev. Proc. 2016-51 currently governs EPCRS.
- EPCRS was previously under Rev. Proc. 2013-12.
- Rev. Procs. 2015-27 and 2015-28 modify certain aspects of Rev. Proc. 2013-12.

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Correct a plan

Rev. Procs. 2015-27 and 2015-28 modify Rev. Proc. 2013-12 corrections in 5 primary areas:

1. Plan Loans
2. Required Minimum Distributions (RMDs)
3. Missed Deferrals
4. Section 415 Corrections
5. Participant Overpayment Corrections

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The Pension Protection Act of 2006 (PPA) endorses the EPCRS program. PPA §1101 gives the IRS formal authority to improve EPCRS including the ability to waive income and excise taxes and to adjust penalties to the facts and circumstances of individual cases. The IRS is encouraged to reduce the need for IRS approvals of voluntary corrections and should specifically consider the circumstances faced by small employers. Rev. Proc. 2013-12 reflects the mandate from §1101 of PPA.

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## Correct a plan

### EPCRS Overview.

- **Three Correction Programs:**
  - Self Correction Program (SCP).
  - Voluntary Correction Program (VCP).
  - Audit Closing Agreement Program (Audit CAP).

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## Correct a plan

- **EPCRS is available for:**
  - Qualified plans (IRC §401(a)).
  - §403(b) plans.
  - SEPs and SARSEPs (IRC §408(k)).
  - SIMPLE IRAs (IRC §408(p)).
  - Voluntary correction for §457(b) eligible government plans.

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**Correct a plan**

➤ **Objectives and Goals:**

- Continued qualification and compliance for covered plans.
- Income tax relief under §§72(p) and 72(t).
- Excise tax relief under IRC 4972, 4973, 4974 and 4979.

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➤ **Correction Principles:**

- Full correction.
- Restore plan and participants to where they would have been if failure had not occurred.
- Reasonable and appropriate correction for the failure.

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➤ **EPCRS identifies four categories of qualification failures:**

- Operational failures, where the plan was not operated according to the plan document or Code requirements.
- Plan document failures, where the document does not comply with the Code's requirements, including the failure to timely adopt required amendments.
- Demographic failures, where the plan fails minimum coverage, minimum participation or nondiscrimination testing.
- Employer eligibility failures, where the employer is not eligible to sponsor a type of retirement plan (e.g., a for-profit corporation trying to sponsor a Code §403(b) plan).

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➤ **Pension Protection Act of 2006 (PPA) §1101:**

- Increase awareness and knowledge of small employers concerning availability and use of EPCRS.
- **IRS should take into account the special concerns and circumstances that small employers face regarding compliance and correction of failures.**
- Extend the duration of self correction under SCP for significant compliance failures.
- Expand availability to correct insignificant compliance failures under SCP during audit.
- **Assure that any tax, penalty, or sanction imposed due to compliance failure is not excessive and bears a reasonable relationship to the nature, extent, and severity of the failure.**

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# EPCRS is an Alternative to Potential Plan Disqualification

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## Plan Disqualification.

- **Advantages of a qualified plan.**
  - Tax savings to the employer:
    - ❖ Immediate deduction of employer contributions. (IRC §404(a)(1), (2), (3), (6), (7)).
    - ❖ Employer contributions are not considered wages and are not subject to FICA/FUTA/Income tax withholding. (IRC §§3121(a)(5), (v)(1); 3306(b)(5), (r)(1); 3401(a)(12)).

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- **Tax savings to the employee:**

Employer contributions made on behalf of an employee are not taxable to the employee in the year in which they are made. Income recognition occurs during the year in which the employee takes a distribution from the plan. (Note: Distributions do not include eligible rollovers to other eligible retirement plans or IRAs.) IRC §402(a), (c)

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- **Tax exempt trust:**

Earnings on contributions made to the trust that forms a part of the qualified plan are not taxable to the trust. The trust is exempt from taxation. (IRC §501(a))

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➤ **Consequences of plan disqualification.**

Loss of tax advantages:

- Contributions are deductible to the employer, only to the extent that they are includible in the gross income of employees participating in the plan. (IRC §404(a)(5))
- Employer contributions to a disqualified plan are not exempt from FICA/FUTA/income tax withholding.
- Contributions made to a trust on behalf of participating employees are includible as gross income to the employees, to the extent that the employees are vested in those contributions. (IRC §402(b)).
- Distributions from the trust are not eligible for tax favored rollover.
- Trust earnings are not exempt from taxation.

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**THE INTERNAL REVENUE SERVICE AUDIT CLOSING AGREEMENT PROGRAM: AUDIT CAP.**

➤ **Audit CAP.**

- For Audit CAP to apply, a plan must have a disqualifying failure.
- The failure may be either in form or Operational.
- All failures are eligible except failures involving a diversion of plan assets or repeated, deliberate or flagrant failures.
- Settlement under Audit CAP is an alternative to the revocation of the plan's qualified status by the IRS.

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- Audit CAP is administered from the IRS Key District Office.
- Full correction is required (including the "closed" years).
- Administrative procedures must be in place so that the defects will not recur.
- IRS sanction amount will be assessed.

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- On audit, Audit CAP is an alternative to disqualification of the plan.
- There is no limit to the monetary sanction for the Audit CAP.
- The Audit CAP settlement amount is based on the plan's **Maximum Payment Amount (MPA)** and generally should not exceed one hundred percent of such amount.

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The Maximum Payment Amount is defined as the tax the IRS could collect upon plan disqualification for the open tax years, including:

- (i) tax on the trust (Form 1041);
- (ii) additional income tax resulting from the loss of employer deductions for plan contributions; and
- (iii) additional income tax resulting from income inclusion for participants in the plan (Form 1040) including distributions that were rolled over; and
- (iv) any other tax that would result from a qualification failure. Rev. Proc. 2013-12, 5.01(5).

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The tax court upheld the disqualification of a tax-qualified retirement plan in *Christy & Swan Profit Sharing Plan v. Commissioner*, T.C. Memo 2011-62. The plan had not been amended to comply with various changes in law. Upon audit, the IRS offered the sponsoring employer a closing agreement and the employer refused.

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➤ **Audit CAP Sanction.**

- Determination of sanction.

The sanction under Audit CAP is a negotiated percentage of the Maximum Payment Amount or a specific dollar amount. For 403(b) plans, SEPs and SIMPLE IRA Plans, the sanction is a negotiated percentage of the Total Sanction Amount. Sanctions will not be excessive and will bear a reasonable relationship to the nature, extent, and severity of the failures. Rev. Proc. 2013-12, Part VI, §14.

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- **Factors considered for Audit CAP sanctions.**

Factors include:

- (i) the steps taken by the Plan Sponsor to ensure that the plan had no failures;
- (ii) the steps taken to identify failures that may have occurred;
- (iii) the extent to which correction had progressed before the examination was initiated, including full correction;
- (iv) the number and type of employees affected by the failure;

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**(v)** the number of non-highly compensated employees who would be adversely affected if the plan were not treated as qualified or as satisfying the requirements of §403(b), §408(k), or §408(p);

**(vi)** whether the failure is a failure to satisfy the requirements of §401(a)(4), §401(a)(26), or §410(b), either directly or through §403(b)(12),

**(vii)** the period over which the failure(s) occurred (for example, the time that has elapsed since the end of the applicable remedial amendment period under §401(b) for a Plan Document Failure), and (viii) the reason for the failure(s) (for example, data errors such as errors in transcription of data, the transposition of numbers, or minor arithmetic errors).

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**VOLUNTARY CORRECTION PROGRAM (VCP):  
CORRECTION WITH IRS APPROVAL.**

➤ Overview of VCP.

A Plan Sponsor, at any time before audit, may pay a limited fee and receive the Service's approval for correction of all Qualification Failures: Operational, Plan Document, Demographic, and Employer Eligibility. Qualified Plans, 403(b) Plans, SEPs, and SIMPLE IRA Plans are all eligible for VCP. Under VCP, there are special procedures for Anonymous Submissions and Group Submissions. **Rev. Proc. 2013-12**, Part I, §1.03.

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**FORMS FILED WITH IRS FOR (VCP):**

- Form 8950 and Form 8951.
- Form 14568 Model VCP Compliance Statement (revised August 2016).

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**VOLUNTARY CORRECTION PROGRAM (VCP):**  
**Key Elements**  
**Ref: §4, 10, 11 and 12 of Rev. Proc. 2013-12**

- Employer submits application with a compliance fee. (Generally fixed under RP 2013-12 and payable up front along with the submission).
- Employer identifies qualification failures to the Service.
- Employer outlines changes in administrative procedures to the Service that would ensure that failures do not reoccur.
- Employer and IRS agree to the methods of correction and the proposed revision of administrative procedures.
- IRS agrees not to pursue the sanction of Plan disqualification with respect to the qualification failures provided that all corrective actions and changes to the administrative procedures are complete within 150 days of the execution of the "compliance statement".

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**Correct a plan**

➤ **The VCP submission from the Plan Sponsor must contain the following:**

- A statement identifying the type of plan submitted (*e.g.*, Qualified Plan, 403(b) Plan, SEP, or SIMPLE IRA Plan);
- A complete description of the failures and the years in which the failures occurred, including closed years;
- A description of the administrative procedures in effect at the time the failures occurred;
- An explanation of how and why the failures arose;
- A description of the methods for correcting the failures that the Plan Sponsor has implemented or proposes to implement;

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- A description of the methodology that will be used to calculate earnings or actuarial adjustments on any corrective contributions or distributions;
- Specific calculations for each affected employee or a representative sample of affected employees;
- The method that will be used to locate and notify former employees and beneficiaries, or an affirmative statement that no former employees or beneficiaries were affected by the failures or will be affected by the correction;
- A description of the measures that have been or will be implemented to ensure that the same failures will not recur;

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- A statement that, to the best of the Plan Sponsor's knowledge, neither the plan nor the Plan Sponsor is Under Examination;
- A statement that neither the plan nor the Plan Sponsor has been a party to an abusive tax avoidance transaction or a brief identification of any abusive tax avoidance transaction to which the plan or the Plan Sponsor has been a party;
- If a submission includes a failure that relates to Transferred Assets and the failure occurred prior to the transfer, a description of the transaction; and
- A statement, if applicable, that the plan is currently being considered in a determination letter application that is not related to the VCP application.

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Correct a plan

- In the case of a 403(b) Plan submission, a statement that the Plan Sponsor has contacted all other entities involved with the plan and has been assured of cooperation in implementing the applicable correction, to the extent necessary.
- A Group Submission must be signed by the Eligible Organization or the Eligible Organization's authorized representative and accompanied by a copy of the relevant portions of the plan document(s).
- In the case of an Orphan Plan, whether relief from the VCP application fee or correction fee requested, in supporting rationale for such relief.

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**Correct a plan**

➤ **The VCP submission must be accompanied by:**

- A copy of the entire plan document or the relevant portions of the plan document;
- In any case in which correction of a Qualification Failure is made by plan amendment, the Plan Sponsor must submit a copy of the amendment;

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**Correct a plan**

- VCP fee submitted by check made payable to the U.S. Treasury. Additional fees may be due for a SEP, SIMPLE IRA Plan, or Group Submission;
- The signature of the Plan Sponsor or the Sponsor's authorized representative. If signed by the Plan Sponsor's representative, a power of attorney must be filed;
- A penalty of perjury statement;
- Completed Forms 8950 and 8951; and
- Completed Form 14568 VCP Compliance Statement (revised August 2016).

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# VCP Check CANNOT Be From the Plan

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➤ **VCP Fees.** (Rev. Proc. 2018-4)

- Qualified Plans and 403(b) Plans

The compliance fee for a submission under VCP for Qualified Plans and 403(b) Plans (including Anonymous Submissions) is determined in accordance with the following chart:

<u>Plan Assets</u>	<u>Fee</u>
\$500,000 or less	\$ 1,500
> \$500,000 - \$10,000,000	\$ 3,000
> \$10,000,000	\$ 3,500

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➤ **Orphan Plans**

- Fee may be waived.
- If a written request is included with the VCP submission, the IRS has discretion to waive the fee if the plan is a terminating orphan plan. Rev. Proc. 2016-15, § 4.08, 11.03(13).

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➤ **Group Submissions**

- The compliance fee for a Group Submission is based on the number of plans affected by the failure as described in the compliance statement. The initial fee is \$10,000 for the first 20 plans. An additional fee is due equal to the product of the number of plans in excess of 20 multiplied by \$250, up to a maximum of \$50,000.
- Rev. Proc. 2016-51, §10.10.
- Rev. Proc. 2018-4.

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### ➤ **§457(b) Plans**

- Subject to negotiated closing agreement sanction.
- No upfront payment required outside of VCP.
- Not subject to VCP fees.

### ➤ **Establishing the Number of Plan Participants**

Compliance fees are determined based on the number of plan participants. For new plans and ongoing plans, the number of plan participants is determined from the most recently filed Form 5500 series. In the case of a terminated plan, the Form 5500 used to determine the number of plan participants must be the one filed for the plan year prior to the plan year for which the Final Form 5500 return was filed.



## SELF-CORRECTION PROGRAM (SCP).

- **Availability of SCP.**

Plan administrators who discover Operational Failures in self-audits can take advantage of the Self-Correction Program (SCP).

  - Operational Failures discovered and corrected within two years of the end of the plan year in which the failures occurred (not discovered) are eligible for SCP relief, even if the Operational Failure is not insignificant.
  - SCP is also available for insignificant Operational Failures that are discovered after the time period for self-correcting the failure has lapsed.

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- **Eligibility for SCP.**

The eligibility requirements for SCP are that:

  - It is available only for eligible **Operational Failures**;
    - ❖ Qualified Plans and 403(b) Plans are eligible with respect to significant and insignificant Operational Failures.
    - ❖ SEPs and SIMPLE IRA Plans are eligible with respect to insignificant Operational Failures only.

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## Correct a plan

- There must be established plan procedures that are "reasonably designed to promote and facilitate overall compliance";
- Any failure must have occurred as a result of an oversight, mistake or "because the procedures that were in plan, while reasonable, were not sufficient to prevent the occurrence of a failure"; and
- The Plan Sponsor must make retroactive correction to all relevant failures.

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## Correct a plan

➤ **Operational Failures Only.**

A Plan Sponsor may use SCP for a Qualified Plan to correct an Operational Failure by a plan amendment to conform the terms of the plan to the plan's prior operations only to correct Operational Failures listed in Appendix B of **Rev. Proc. 2013-12**. The amendments must comply with the requirements of §401(a), including the requirements of §§401(a)(4), 410(b), and 411(d)(6). Moreover, SCP is not available for plans with disqualifying provisions (as defined in the Regulations under I.R.C. §401(b)) for which the remedial amendment period has expired. Finally, SCP is not available to a Plan Sponsor for failing to timely amend its plan.

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- **Not Available for Misuse of Plan Assets.**

SCP is ***not*** available for exclusive benefit failures relating to the misuse or diversion of plan assets.

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Correct a plan

- **Established Practices and Procedures Required.**

Eligibility for participating in the SCP requires that the plan administrators have established practices and procedures in place, both formal and informal, that are reasonably designed to promote and facilitate overall compliance with qualification requirements of the I.R.C. Examples of these procedures include a checklist to track allocations and identifying key employees. A plan document alone will not constitute evidence of established procedures.

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➤ **Full Correction Required.**

The Plan Sponsor must make full correction of all failures for all years for which the failures exist. The correction method should restore to both current and former participants and their beneficiaries the benefits and rights they would have had if the failure not occurred. The correction method should restore the plan to the position it would have been in had the failure not occurred.

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➤ **Correction Within Two Plan Years.**

- Any Operational Failure, whether or not the failure would be considered insignificant, that is corrected by the Plan Sponsor by the end of the second plan year following the plan year in which the Operational Failure occurred is a non-disqualifying event.
- There are no limitations on the number of years a Plan Sponsor can use this self-correction procedure.
- This is a **KEY PERIOD** — referred to as "the period during which significant failures may be corrected under SCP".

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Correct a plan

- **Current IRS Determination Letter or Opinion Letter Required.**

This self-correction procedure is available only to a sponsor of an individually designed plan (including a volume submitter plan) with a current determination letter, an adopter of a master or prototype plan with a current opinion letter, or an adopter of a regional prototype plan with a current notification letter.

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- **Failure Cannot Be Egregious.**

Egregious Failure Examples:

- Plan covers only HCEs.
- Plan provides HCEs benefits that are several times 415 limits.

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**Correct a plan**

- **Not Available if Plan is Under Examination.**
  - This self-correction procedure will not be available for correcting any failures in a plan for any plan year that is under employee plans or exempt organization examination.
  - However, the IRS may permit agreed self-correction during an exam.

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**Correct a plan**

- **Insignificant Operational Failures.**

Operational Failures that are not self-corrected within the two plan year period described above are nevertheless considered non-disqualifying events and eligible for SCP if, given all the facts and circumstances of a case, the Operational Failures are considered to be insignificant.

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Correct a plan

The factors to be considered in determining whether Operational Failures under the plan are significant include (but are not limited to):

- Whether other failures have occurred during the period being examined;
- The percentage of plan assets and contributions involved in the failure;
- The number of years the failure occurred;

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Correct a plan

- The number of participants affected relative to the number of participants in the plan;
- The number of participants affected as a result of the failure relative to the number of participants that could have been affected by the failure;
- Whether correction was made within a reasonable time after discovery of the failure; and
- The reason for the failure (*e.g.*, data errors, transposition of numbers or minor arithmetic errors).

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Correct a plan

No single factor is determinative. The fact that one or more factors are not applicable to a given case will not prevent the plan from being eligible for SCP.

A plan with more than one Operational failure in a single year may be eligible for SCP if the violations in the aggregate are considered insignificant. Failures will not be considered significant merely because they incur in more than one year.

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➤ **Correction By Retroactive Plan Amendment.**

Under SCP, plan amendments can only be used in four specified situations and corrections methods provided for in Appendix B of Rev. Proc. 2013-12. (In order to complete correction by plan amendment under SCP a determination letter application must be submitted before the end of the plan's remedial amendment period.) They are:

- 1. Failure to comply with IRC §401(a)(17) limit.** The employer contributes an additional amount on behalf of each of the other employees (excluding each employee for whom there was a §401(a)(17) failure) who received an allocation for the year of the failure, amending the plan (as necessary) to provide for the additional allocation.

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**2. Contrary to the terms of the plan document, the plan provides for hardship distributions.** The plan is amended retroactively to provide for the hardship distributions that were made available. This amendment is permissible if the amendment does not cause the plan to violate another 401(a) provision, *e.g.*, benefits, rights and features issues under IT Reg. 1.401(a)(4)-4).

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**3. Contrary to the terms of the plan document, the plan provides for participant loans.** The plan is amended retroactively to provide for the loans that were made available. This amendment is permissible if the amendment (i) satisfies 401(a) and (ii) the plan as amended would have satisfied the qualification requirements of 401(a) (and the requirements applicable to plan loans under §72(p)) had the amendment been adopted when plan loans were first made available.

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**4. Ineligible employees (age and service; entry dates).**  
The plan is amended retroactively to change the eligibility provisions to provide for the inclusion of the ineligible employee to reflect the plan's actual operations. This amendment is permissible if the amendment does not cause the plan to violate another 401(a) provision.

Ineligible employees include employees who either:

- (i) have not completed the plan's minimum age or service requirements; or
- (ii) have completed the plan's minimum age or service requirements but became participants earlier than the applicable entry date.

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## Specific Correction Methodology

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## Operational Failures and Correction Methods

- The following sets forth Operational Failures and Correction Methods relating to Qualified Plans. These correction methods are acceptable under VCP and SCP. To the extent the failure listed below could occur under a 403(b) Plan, a SEP, or a SIMPLE IRA Plan, the correction method listed for such failure may be used to correct the failure.

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- **Rev. Procs. 2015-28.**  
Missed Deferral Corrections for:
  - Automatic Enrollment Plans
  - Automatic Increases in Deferrals
  - Errors in Implementing Deferral Elections

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➤ **Auto Enrollment / Auto Increase.**

No Employer contribution required if failure is found and corrected by earlier of:

- 9½ months after the end of the Plan Year in which the auto contribution or increase should have occurred; or
- The last pay of the month following the month in which the Participant advises the Plan Sponsor of the error.

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➤ **Deferral Errors Discovered Within Three Months**

No Employer contribution required for missed deferrals in prior rolling three month period if deferrals are started by the first payroll after the earlier of:

- 3 months after the missed deferral occurred; or
- The last pay of the month following the month in which the participant informs the Plan Sponsor of the error.

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Correct a plan

For both Auto Enrollment / Auto Increase and Deferral Errors discovered within 90 days:

- Missed matching contributions must be made within SCP two-year correction period.
- Notice of the failure must be given to affected participants within 45 days after date of correction.

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➤ **Elective Deferral Errors that Exceed Three Months**

- Employer contribution is **25%** of missed deferrals if **corrected by the last day of the second Plan Year** following the Plan Year in which the error occurred.
- Employer contribution is **50%** of missed deferrals if **not** corrected within the two-Plan Year period noted above.
- Notice of the failure must be given to affected participants within 45 days after date of correction.

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- **For all missed deferral corrections, the Employer must also contribute:**
  - The matching contribution (plus earnings) that the Participant would have received if deferrals had been properly implemented.
  - Employer must provide notice to affected Participants within 45 days of date of correction.

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**Correct a plan**

- **Missed Deferral Correction Summary:**

Correction Period	Percentage of Missed Deferrals
Within 90 Days	0%
Within 2 Plan Years	25%
More Than 2 Plan Years	50%

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**Correct a plan**

**Cannot Stack Corrections.**

- **If missed correction is more than two years, correction is 50% of entire amount — including missed deferrals within 90 days and two years.**

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**Correct a plan**

- **Exclusion of an eligible Employee from all contributions or accruals under the Plan for one or more years.**
  - Employer contribution to Plan or provide benefit accrual on behalf of excluded Employees.
  - If Plan has elective deferrals, correction is QNEC in percentages noted above based on ADP for the Employee's group (NHCE or HCE).

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➤ **Overpayment of Benefits.**

Rev. Proc. 2013-12 required that the Plan take reasonable steps to collect the money from the Participants.

Rev. Proc. 2015-27 provides two additional options:

- The Employer can pay the overpayment with or without trying to recover it from the Participant; or
- The Employer can retroactively amend the Plan to conform to the distributions made.

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➤ **Failure to timely pay Required Minimum Distributions (RMD) under IRC §401(a)(9). Rev. Proc. 2015-27.**

- Distribute the RMD amount and any gains or losses for all prior years.
- Special VCP fee based on number of affected Participants:

Participants with RMD Failures	VCP Fee
1 – 150	\$ 500
151 – 300	\$1,500
> 300	Standard VCP Fee

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➤ Participant Loans.

- Loan provisions **NOT** in Plan:
  - ❖ Amend Plan to include loan provisions.
- Failure to reflect loan in default:
  - ❖ Report loan as income to Participant in year of discovery, rather than year of default.

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➤ **Participant Loans — Special VCP fee based on number of affected Participants. Rev. Proc. 2015-27.**

Participants with Loan Failures	VCP Fee
1 — 13	\$ 300
14 — 15	\$ 600
51 — 100	\$1,000
101 — 150	\$2,000
> 150	\$3,000

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Correct a plan

- I.R.C. §415 Failures. Rev. Proc. 2015-27.
  - Distribute excess deferrals over §415 limit within 9½ months after the end of the Plan Year.

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Correct a plan

- Excess Allocations.
  - ❖ Excess employer contribution:
    - Correction mechanism based on plan provisions;
    - Reallocation among other participants; OR
    - Reallocation to unallocated account to be used to reduce Employer contributions.
  - ❖ Excess elective deferrals or after-tax employee contributions:
    - Distribute excess (plus earnings) to employee. Report as income in year of distribution.
- Distribute within 9½ months after the end of the year.

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Correct a plan

- Failure to provide the minimum top-heavy benefit under I.R.C. §416 to non-key employees.

In a Defined Contribution plan, contribute and allocate the required top-heavy minimums to the plan in the manner provided for in the plan on behalf of the non-key employees.

In a Defined Benefit plan, the minimum required benefit must be accrued in the manner provided in the plan.

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Correct a plan

- Failure to satisfy the actual deferral percentage (ADP) test, the actual contribution percentage (ACP) test.

Make qualified non-elective contributions on behalf of the non-highly compensated employees to the extent necessary to raise the actual deferral percentage or actual contribution percentage of the non-highly compensated employees to the percentage needed to pass the test.

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Correct a plan

- Failure to distribute elective deferrals in excess of the I.R.C. §402(g) limit.

Distribute the excess deferral to the employee and report the amount as taxable in the year distributed.

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Correct a plan

- Failure to obtain participant and/or spousal consent for a distribution subject to the participant and spousal consent rules under I.R.C. §§401(a)(11), 411(a)(11) and 417.

Give the affected employees the choice of providing informed consent for the distribution actually made or receiving a qualified joint and survivor annuity. In the event that participant and/or spousal consent is required but cannot be obtained, the participant must receive a qualified joint and survivor annuity. This annuity may be offset for any amounts already received by the participant. In the event that spousal consent is required but cannot be obtained, the employer must provide a survivor annuity. A spousal survivor annuity may not be offset by any amounts received by the participant.

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➤ **DOL VFCP Online Calculator:**

VFCP online calculator can be used to calculate earnings adjustments

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➤ **Distribution of Small Amounts:**

If the total corrective distribution is \$75 or less, the plan sponsor is not required to make a 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. §6.02(5)(b) Rev. Proc. 2013-12.

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Correct a plan

**Example 1:**

- Plan definition of compensation excludes bonuses for purposes of employer contributions and elective deferrals.
- Jane receives a \$30,000 bonus and contrary to plan terms:
  - ❖ Receives additional 5% profit sharing contribution (\$1,500)
  - ❖ Makes 6% elective deferrals (\$1,800)

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Correct a plan

**Correction:**

- Forfeit profit sharing allocations of \$1,500 plus earnings, place in an unallocated account to be used for profit sharing allocations
- Distribute improper elective deferrals of \$1,800 plus earnings

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**Correct a plan**

**Example 2:**

- Plan definition of compensation **includes** bonuses for purposes of employer contributions, elective deferrals.
- In operation, contrary to plan terms, bonuses were **excluded**. Bob elected to defer 5% of compensation. The profit sharing contribution for the year was 3% of compensation. Bob's bonus for the year was \$10,000.

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**Correct a plan**

**Correction:**

- **Deferrals:** Bob was not provided with the opportunity to make deferrals from "bonus" compensation. If Bob's election was properly implemented, an additional \$500 (5% x \$10,000) would have been withheld for deferrals. The percentage for the Employer correction depends upon the timing of the correction.
- **Employer Profit Sharing Contribution:** By not counting bonuses, Bob's profit sharing contribution was understated by \$300 (3% X \$10,000). The Employer should make a corrective contribution of \$300 (adjusted for earnings) on behalf of Bob.

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## Exclusion of Eligible Employees (General Rules of Correction)

**General Rule:**

- **Elective Deferrals:** Employer makes a corrective contribution to replace the missed deferral opportunity for the period of exclusion. Missed deferral opportunity = Employee's missed deferral (estimated using ADP for the Employee's category during the year of exclusion).  
  
The percentage for the Employer correction depends upon the timing of the correction.
- **Matching Contributions:** Employer makes a corrective contribution equal to contributions Employee would have received had the missed deferral been made.

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## Exclusion of Eligible Employees (Variations)

- Failure to implement employee elections.
  - ❖ Use employee's elective deferral percentage instead of ADP
- Failure to implement an employee's election for all categories of compensation (e.g., bonuses)
  - ❖ May be able to calculate missed deferral using the employee's election in file.

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## Correction of Failed ADP/ACP Tests

- Correction can be made within 12 months after the end of the plan year [IRC §401(k)(8), §401(m)(6)]
- If 12 months have elapsed since close of the plan year: EPCRS is available.
- EPCRS corrections:
  - ❖ Uniform QNEC
  - ❖ 1 to 1 correction

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## Safe Harbor 401(k) Plan — Failure to Provide Notice

- **Correction depends on the impact on individual participants.**
  - ❖ If failure to provide notice results in an employee not being able to make elective deferrals to the plan, then the failure to provide notice would result in the erroneous exclusion of an eligible employee. Corrective contributions on behalf of the employee would be required.
  - ❖ If employee otherwise informed and able to make elective deferrals, then correction may involve revising practices and procedures going forward.

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## Failure to Suspend Deferrals

- 401(k) plan provides that upon receiving a hardship distribution, the participant is prohibited from making elective deferrals for 6 months. In operation, plan fails to suspend deferrals. Correction?

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## Failure to Suspend Deferrals cont'd.

- **Option 1** – Can plan return the improper elective deferrals (adjusted for earnings) to employee?  
Yes. This would put the participant in the same position he or she would have been in had failure not occurred.
- **Option 2** – Can plan suspend elective deferrals for a 6 month period going forward?  
Possibly. However, this may not put the participant in the same position.
  - ❖ Matching contribution levels for the 6 month period going forward could be different than what they were during suspension period.
  - ❖ Participant may quit employment before expiration of 6 month period.

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