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webcast

Plan Sponsor Basics

Webinar 1 of 6

Voluntary Correction of Retirement Plan Defects

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Introduction

- What we will cover today
  - Brief history and overview of voluntary retirement plan correction programs as currently embodied in the Employee Plans Compliance Resolution System (EPCRS)
  - Fundamental concepts and correction principles of EPCRS
  - Recent updates to EPCRS
  - Examples of common EPCRS corrections

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Introduction (cont'd)

- Overview and history of retirement plan corrections
  - Back in late 80s and early 90s, no good way to correct retirement plan defects
  - Plan sponsors and IRS faced with unappealing choices – plan disqualification, "audit lottery," etc.
  - IRS began experimenting with an alphabet soup of correction programs: CAP, APRS, VCR, Walk-in CAP, etc.
  - Programs very successful and, in 1998, IRS wrapped them together into first consolidated version of EPCRS

Introduction (cont'd)

- Some of the fundamental principles of EPCRS:
  - Full correction for all years (not just open tax years)
  - Correction should restore participants to position that they would have been in had the error not occurred
  - Correction should be applied consistently to all participants and consistently across all affected years
  - Correction may not create another error/issue and may not be discriminatory
  - Where possible, correction should keep assets in the plan
  - Plan sponsors entitled to rely on correction

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Introduction (cont'd)

- Current version of EPCRS includes three primary component programs
  - Self-Correction Program (SCP), which enables plan sponsors to self- correct "operational" errors that are:
    - *"Insignificant" errors can be corrected anytime*
    - *"Significant" errors can be corrected within two-year window following year in which error occurs*
    - *Corrected in accordance with recognized, reasonable and appropriate correction methods*
  - Voluntary Correction Program (VCP), which enables plan sponsors to correct just about any "plan document," "operational," or "demographic" failure

Introduction (cont'd)

  - *Submission to the IRS and payment of an application "fee"*
  - *Potentially more flexibility regarding correction approaches, including retroactive amendments*
- Audit CAP to correct any sort of failure identified during an IRS plan audit
  - *No set penalty or fee, but sanction amount negotiated as a percentage of "maximum payment amount" and depending upon nature/extent of issues, can be significant*
- EPCRS is a valuable and helpful tool to correct plan defects, but it places pressure on plan sponsors to take advantage of it when errors are identified

Recent Changes to EPCRS

- New EPCRS is an incremental evolution of correction program and not a dramatic overhaul
- Several categories of changes under new EPCRS
  - Some procedural changes affecting all types of plans
  - Changes affecting defined contribution plans
  - Changes affecting defined benefit plans
  - Changes affecting 403(b) plans
- Not an exhaustive list of all changes

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Procedural Changes Affecting All Plans

- Adds Form 8950, Application for Voluntary Correction Program
- Adds Form 8951, Compliance Fee for Application for Voluntary Correction Program Submission under the Employee Plans Compliance Resolution System
- Model Appendix C, Parts I and II (consolidates prior Appendices D and F)
- Electronic, interactive versions of Appendices C and D available
- Photocopy of submission fee required

Procedural Changes Affecting All Plans (cont’d)

- Revises VCP compliance fees and adds additional reduced fees
  - $500 fee for failure to timely adopt an amendment upon which a favorable determination letter is conditioned (but only if the failure is identified and corrected quickly)
  - Temporary 50% reduction for a submission covering a failure to timely adopt a 403(b) plan
  - Fee for a submission covering multiple failures subject to a reduced fee will be the sum of the reduced fees
  - Fee under Audit CAP increased for non-amender failures discovered during determination letter application

Changes Affecting Defined Contribution Plans

- Correction methods expanded to correct failures under certain types of safe harbor plans
  - Failure to provide participant with the opportunity to make an affirmative deferral election under an automatic contribution arrangement that satisfies the safe harbor requirements under Code section 401(k)(13) (also called a QACA or qualified automatic contribution arrangement)
  - Failure to make required non-elective contribution under either a “traditional” safe harbor plan under Code section 401(k)(12) or a QACA

Changes Affecting Defined Contribution Plans (cont'd)

- Corrective contributions involving matching contributions owed to a participant now can be made using "corrective employer matching contributions," which are subject to a plan's vesting schedule and are not subject to the vesting and distribution restrictions imposed on QNECs
- QNECs must be used to correct non-discrimination failures (e.g., ADP/ACP test failures, etc.)
  - Use of forfeitures NOT permitted
  - QNECs must come from the plan sponsor's general assets

Changes Affecting Defined Contribution Plans (cont'd)

- In the case of errors involving overpayments to plan participants
  - Plan sponsor must make the plan whole if the participant doesn't repay the overpayment
  - Make-whole requirement no longer required when overpayment was solely due to a premature distribution

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Changes Affecting Defined Benefit Plans

- EPCRS establishes rules for correcting failures to comply with Code section 436 benefit restrictions
  - Code section 436 benefit restrictions (e.g., limits on lump sums, benefit increases, etc.) applies to plans with funding levels that fall below 80% “AFTAP”
  - Corrections generally requires a plan contribution to make up for the failure
- EPCRS recognizes that corrective distributions and amendments to correct unrelated failures are not, themselves, subject to Code section 436 benefit restrictions (but, correction may require additional plan contribution)

Changes Affecting Defined Benefit Plans (cont'd)

- For corrective distributions from a defined benefit plan, any adjustments for interest/earnings are based on the interest rate used to determine actuarial equivalence under the plan

Changes Affecting 403(b) Plans

- 403(b) plans generally treated like other types of qualified plans for purposes of most types of failures
- Plan document failures now covered under EPCRS
- In particular, VCP available for failure to adopt plan document by 12/31/09
  - Reduced user fee if corrected before 12/31/13
  - Available to plans currently under audit
- Specific correction for failure to satisfy “universal availability” rule that is unique to 403(b) plans

Example – Exclusion of Otherwise Eligible Employees

Example:

- ABC Company maintains a safe harbor 401(k) plan that has a QACA automatic enrollment feature
- Initial qualified percentage is 3% with a 1% increase for each subsequent year, up to 10%
- Plan also provides a safe harbor matching contribution equal to the sum of (a) 100% of elective deferrals up to 1% of compensation plus (b) 50% of the elective deferrals that exceed 1% but do not exceed 6% of compensation
- Safe harbor matching contributions are subject to a two-year cliff vesting schedule

Example – Exclusion of Otherwise Eligible Employees (cont'd)

Example (cont'd):

- Jane, a non-highly compensated employee who met the plan's eligibility requirements and should have entered the plan on January 1, 2012, was not provided with the required QACA notice and was not automatically enrolled at 3%
- She was erroneously excluded for all of 2012
- Her compensation for 2012 was $50,000

Example – Exclusion of Otherwise Eligible Employees (cont'd)

Correction:

- In general, correction is QNEC for 50% of missed deferral opportunity and 100% of missed match
- Jane's missed deferral opportunity is $750
  - Jane's missed deferral is deemed to be 3% of her compensation, which means that 3% of $50,000 = $1,500 times 50% = $750
- The corrective employer matching contribution for Jane's missed matching contribution is $1,000
  - 100% of deferrals up to 1%, plus 50% of the next 2% of deferrals (that is, $500 + $500)

Example – Exclusion of Otherwise Eligible Employees (cont'd)

Correction (cont'd):

- The matching contribution can be subject to the plan's two-year vesting schedule and distribution rules
- The total corrective contribution is $1,750, plus earnings
  - $750 QNEC for missed deferral opportunity
  - $1,000 corrective employer matching contribution
- The total corrective contribution must be adjusted for earnings

Example – Universal Availability Rule

Example:

- ABC Organization's 403(b) plan provides a matching contribution equal to 100% of elective deferrals up to 4% of compensation
- Plan's matching contributions are subject to four-year graded vesting (vesting 25% per year)
- Bob met the plan's eligibility requirements but was not provided an opportunity to make elective deferrals to the plan
- Bob was erroneously excluded for all of 2012 and Bob's compensation for 2012 was $40,000

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Example – Universal Availability Rule (cont'd)

Correction:

- EPCRS recognizes that the correction approach for this 403(b) plan failure is generally the same as for excluding employees from participation in a non-403(b) plan
- QNEC equal to 50% of Bob's missed deferral opportunity and 100% of missed match
  - Bob's missed deferral opportunity of 4% of his compensation is $800 (4% of $40,000 = $1,600 times 50% = $800)
  - Bob's missed matching contribution of 100% of his missed deferral is $1,600

Example – Universal Availability Rule (cont'd)

Correction (cont'd):

- The total corrective contribution is $2,400, plus earnings
  - $800 QNEC for missed deferral opportunity
  - $1,600 corrective employer matching contribution that can be subject to the plan's four-year vesting schedule and distribution rules

Example – Plan Subject to Code Section 436

Example:

- XYZ Company maintains a defined benefit plan
- Plan failed to begin distributing to retiree Ralph his required minimum distribution (RMD) by April 1, 2010
- Mistake is discovered in 2012 and Ralph has not received any distributions from the plan
- Plan's AFTAP is 50% and, as a result, the plan is subject to Code section 436 benefit restriction that lump sums cannot be made from the plan

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Example – Plan Subject to Code Section 436 (cont'd)

Correction:

- Plan distributes missed RMDs, plus interest, to Ralph
- Interest is based on the plan's actuarial equivalence factors in effect on the date that the RMDs should have been made
- Lump sum make-up distribution will not be treated as a violation of the Code section 436 benefit restriction so long as XYZ Company contributes the amount of Ralph's corrective distribution to the plan

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