## New EPCRS Options to Correct Deferral Errors



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## New EPCRS Options to Correct Deferral Errors



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One of the most common errors in 401(k) and 403(b) plan administration is when an

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

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

There are three components to the correction program:

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

Missed deferrals generally may be corrected under SCP.



The most recent EPCRS was released in 2012 and prescribes that if an employer fails to implement an employee deferral election or fails to make

an employee aware of his eligibility to defer, it must fund a contribution of 50% of an assumed missed deferral amount, plus any match the employee would have received had ALL of his deferrals been deposited, plus applicable earnings up to the date of correction.

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

After reviewing comments from the public, in early April, 2015 the IRS modified the EPCRS language to add correction options for deferral errors related to automatic contribution features and to reduce the required corrective contribution for some missed deferrals that are of a limited duration. The modifications, found in Rev. Proc. **2015-28** supplement the EPCRS, which is found in Rev. Proc. **2013-12**. The modified rules do bring welcome relief for plan sponsors seeking to correct deferral errors. However, since the modifications were issued as a subsequent Rev. Proc. that must be considered in combination with the earlier EPCRS Rev. Proc., the rules have become more difficult to follow, as you have to look at both Rev. Procs. to determine the correction options. A new, updated EPCRS that combines all of the options and eliminates language that is no longer applicable (and ideally streamlines

the rules into a comprehensive chart format) is greatly warranted. In addition, the new rules provide additional correction provisions that are only available to plans that use automatic enrollment, which muddles the waters when it comes to determining which correction option is appropriate. Some areas that seem unclear:

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

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

2013-12 Rev. Proc. EPCRS with modifications from I	Rev. Proc. 2015-28			
Error	deferral correction	match correction	earnings adjustment	notice to employee*
			based on rate applicable to	
			employee's investment	
		match must be calculated under the	choices for the period of	
Failure to provide opportunity to make pre-tax		terms of the plan as if the missed	failure. Rate of return of	
elective or designated Roth deferrals OR failure to		deferrals had been contributed to the	fund with highest return	
implement an election on a timely basis.	Employer must:	plan.	rate made by used.	not required.
			If employee had no	
	make a QNEC equal to 50% of the	match and related earnings must be	investment elections,	
(this correction method will apply UNLESS one of	missed deferral** plus earnings (see	deposited by last day of second plan	earnings may be based on	
	NOTE at bottom with respect to Roth	year following the plan year of	rate of return under plan as	
the situations below is applicable) $\int_{0}^{\infty}$	QNEC)	failure.	a whole.	

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

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

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

Rev Proc 2015-28 is set to expire on 12/31/2020.					
The Service will consider whether to extend the co	rrection methods.				
* Content of notice requirement: General informati	on relating to the failure, such as % of o	compensation that should have been de	eferred and the date deferrals	should have begun.	
A statement that appropriate amounts have begun	to be deducted and contributed or will l	begin shortly.			
A statement that corrective contributions relating to	o missed match have been made or will	l be made.			
An explanation that affected participants may incre	ase their deferral percentage in order t	o make up for the lost deferrals, subjec	t to limits under 402(g).		
Name of plan and plan contact info, including name	, street address, email address, and pho	one number.			
** The missed deferral for an employee who filed a	n election is the elected deferral percer	ntage multiplied by compensation, or th	e specified dollar amount, if a	applicable.	
If the employee did not file an election:					
The missed deferral for a plan that is NOT safe harb	or is the ADP for the employee's group	multiplied by his compensation. 2013-1	2 Appendix A .05(2)(b)		
The missed deferral for a safe harbor plan is the gre	ater of 3% of compensation or the max	ximum deferral percentage for which th	e employer provides a 100% s	safe harbor match. 2013-12 A	ppendix A .05(2)(d)(i)
The missed deferral for a plan that is safe harbor ar	d uses an automatic contribution featu	ire, and the failure does not extend pas	st the last day of the first plan	year beginning after the date	of failure,
is equal to 3% of compensation.					
The missed deferral for a plan that is safe harbor ar	d uses an automatic contribution featu	ire, and the failure extends past the las	t day of the first plan year beg	ginning after the date of failure	e,
is equal to the qualified percentage specified in th	e plan. 2013-12 Appendix A .05(2)(d)(ii)				
For after-tax (non-Roth) contributions, the missed c	ontribution is the ACP for the employee	e's group multiplied by compensation (c	only counting the portion of th	e ACP attributable to after-ta	x contributions).
NOTE: no corrective contributions for missed defe	errals may be treated as Roth contribu	tions. 2013-12 Appendix A .05 (3)			

