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PLAN CORRECTIONS

The Updated EPCRS: Logic is the Beginning of Wisdom

In July 2021, the Internal Revenue Service issued Revenue Procedure 2021-30, which contains the current version of EPCRS, replacing the version found in Revenue Procedure 2019-19. This column discusses those changes.

BY ADRIENNE I. MOORE

Adrienne I. Moore is a senior associate attorney at the Ferenczy Benefits Law Center in Atlanta, GA. Ms. Moore received her JD from the University of Georgia School of Law and began work with the Ferenczy Benefits Law Center in 2017 after three years in the tort and environmental litigation group of a large Atlanta law firm.

Just to keep us on our toes, the Internal Revenue Service (the Service) occasionally surprises us with an updated version of the Employee Plans Compliance Resolution System (EPCRS). EPCRS is the system that provides retirement plan sponsors with the ability to correct operational, demographic, and document failures that arise during a plan's life. In July 2021, the Service

issued Revenue Procedure 2021-30, which contains the current version of EPCRS, replacing the version found in Revenue Procedure 2019-19. Most changes in the new EPCRS became effective July 16, 2021, the date of issuance.

Some of the modifications are just in keeping with the times, such as increasing the dollar limits for *de minimis* corrections, or clean up duty, in the case of the extension of the safe harbor correction method for enrollment failures in plans with automatic contribution arrangements, which expired last year. One section, in particular, got quite the overhaul. The current EPCRS has implemented two new correction options for overpayment failures from defined benefit plans that take into account plan funding levels and any increased minimum funding requirements

that were the result of the overpayment. While this may not sound exciting, the updates provide for greater flexibility for plan sponsors based on practical considerations in administration. Then, just to be generous, the Service also extended the correction period for self-correction by a year.

Overpayment Corrections

Corrections in Defined Benefit Plans

For several years, plan sponsors have been able to correct overpayments from defined benefit plans by making a single lump sum repayment (either by the affected participant or some other party) or by reducing future payments to the participant. [Rev. Proc. 2019-19, Appendix B, §§ 2.04(1), 2.05] With the updated EPCRS, the Service has preserved these correction methods but now provides that an affected participant may correct an overpayment by repaying the excess amount in installments, as opposed to a single lump sum. [Rev. Proc. 2021-30, Appendix B, § 2.05(2)(a)(i)] To make use of the installment option, the affected participant cannot be a disqualified individual (that is, a plan fiduciary, owner, or certain relatives of those individuals) or an owner-employee, as those terms are defined in the Internal Revenue Code (Code). [Rev. Proc. 2021-30, Appendix B, § 2.05(2)(a)(ii), Code §§ 4975(e)(2), 401(c)] It appears that, in principle, if someone is a decision-maker for the plan or the employer, s/he should know better than to receive an overpayment; therefore, the participant is not entitled to make installment repayments.

The Service also created two new methods for correction that provide greater flexibility for defined benefit overpayments: (1) the funding exception correction method and (2) the contribution credit correction method. Under the funding exception correction method, EPCRS does not require repayment of the excess amount so long as the plan meets certain funding requirements. For a plan subject to Code Section 436, the plan meets the requirements if its certified or presumed Adjusted Funding Target Attainment Percentage (AFTAP) is at least 100 percent. [Rev. Proc. 2021-30, Appendix B, § 2.05(3)] The AFTAP—roughly the percentage of accrued benefits that can be provided by the plan's current assets—is calculated annually by the actuary and reported on Schedule SB of a plan's annual report. In the period between certifications, the presumed AFTAP is deemed to equal the certified AFTAP for the preceding plan year. [Code § 436(h)]

Example: The Mizuno Plan's certified AFTAP for the 2021 plan year is 120 percent. The Mizuno Plan distributes an excess amount of \$5,000 to Thomas in April 2022, before the actuary has certified the AFTAP for the 2022 plan year. The presumed AFTAP is 120 percent, and the plan can correct the overpayment through the funding exception correction method without requiring Thomas to repay anything.

Similarly, in a multiemployer plan, the plan can use this correction method if its most recent annual funding certification indicates that the plan is not in critical, critical and declining, or endangered status under Code Section 432. Note that if the overpaid participant is receiving regular payments (for example, monthly payments), future payments must also be reduced to the correct benefit payment amount, or a new overpayment will occur.

If a plan does not have a sufficient funding status to use the funding exception correction method, it would follow that the overpaid amount must be returned to the plan. In considering this, the Service has cleverly created the new contribution credit correction method. Using this method, the amount of the corrective payment is reduced by the cumulative increase in the plan's minimum funding requirements attributable to the overpayment. [Rev. Proc. 2021-30, Appendix B, § 2.05(4)(a)(i)(A)] Because the plan's minimum funding requirements have increased, the plan sponsor has made larger contributions to the plan. The needed repayment to correct the overpayment failure is reduced by the additional contributions required by the actuary's calculations in the interim. In other words, the plan sponsor is getting credit for its higher contributions.

The increase in the minimum funding requirements is determined beginning with the first plan year for which overpayments are taken into account for funding purposes through the end of the plan year *preceding* the plan year for which the corrected benefit payment amount is taken into account for funding purposes. Practically speaking, then, if the plan year is a calendar year, an overpayment issued in 2021 would be considered in the 2021 funding determination and would increase the otherwise required minimum funding for 2021 (even though that amount is, in all likelihood, funded sometime in 2022). This is the starting point for determining the increase in minimum funding requirements. If the overpayment is then being repaid in 2025, the 2025 testing and minimum funding

would take into account the correction. Therefore, the period of increased minimum funding would run from 2021 through 2024, the year preceding the correction. The overpayment correction is further reduced by certain additional contributions in excess of the minimum funding requirements paid to the plan after the first overpayment (or first of the overpayments) was made. [Rev. Proc. 2021-30, Appendix B, § 2.05(4)(a)(i)(B)] Let us consider an example.

Example: An overpayment of \$5,000 is distributed from the Mizuno Plan in 2020. Because of this, the 2020 and 2021 valuations cause an increase of \$1,000 in the minimum funding requirements in each year. Additionally, the plan sponsor contributed \$1,000 above the minimum funding requirement in 2021. The overpayment is corrected in 2022. The total contribution credit is \$3,000 (\$2,000 in increased minimum funding and \$1,000 in additional contributions). Therefore, the total overpayment that must be repaid is only \$2,000 (\$5,000 initial overpayment less the \$3,000 contribution credit), and not the full \$5,000.

Corrections of Overpayments in Defined Contribution Plans

The correction methods for defined contribution plans have not changed. The Service did, however, rearrange the sections to make the corrections clearer. In prior versions, the section addressing defined contribution plan corrections was combined with that of defined benefit plans and did not explicitly lay out the correction for a defined contribution plan, instead referencing the correction methods for defined benefit plans. The updated EPCRS provides a separate section to specifically address overpayment corrections in defined contributions plans. [Rev. Proc. 2021-30, Appendix A, § 2.04]

De Minimis Accounts

EPCRS has long accounted for the possibility of corrections that are so small that the Service provides an exception to the general principle of EPCRS that any failure must be fully corrected. This exception applies to *de minimis* failures. Prior to Rev. Proc. 2021-30, the defined *de minimis* amount that required no correction under EPCRS was \$100. [Rev. Proc. 2019-19, Section 6.02(5)(c), (e), § 6.11(5)(c)] This was unchanged for many years.

Presumably to keep up with inflation, the current EPCRS now uses a threshold of \$250. If an

overpayment to a participant (or beneficiary) did not exceed \$250, the plan sponsor does not need to seek repayment of the overage from the recipient, nor does it need to notify the recipient that the overpaid amount was not eligible for favorable tax treatment (that is, that it was not eligible for rollover). [Rev. Proc. 2021-30, § 6.02(5)(c)]

Similarly, the new Procedure does not require correction of excess amounts that do not exceed \$250. [Rev. Proc. 2021-30, § 6.02(5)(e)] A small excess amount is an excess allocation in a defined contribution plan that has not yet been distributed. Once it is distributed, it becomes an overpayment. Small excess amounts, even if they do not exceed \$250, still must be corrected through distribution or forfeiture if a statutory limit, such as Code Section 415, is exceeded. In such an instance, the participant must also be notified that the excess is not eligible for favorable tax treatment.

A similar rule is provided for simplified employee pension (SEP) and Savings Incentive Match Plan for Employees Individual Retirement Account (SIMPLE IRA) plans. If the total excess amount, whether deferrals or employer contributions, is \$250 or less, the excess does not need to be distributed. Moreover, the 10 percent sanction for retention of excess amounts does not apply. [Rev. Proc. 2021-30, § 6.11(5)(c)]

Anonymous Submissions

One major change with the updated EPCRS, which will not be effective until January 1, 2022, is the elimination of the anonymous submission option. This is the one significant unfortunate change, as it terminates a useful correction tool in favor of what appears to be a poor substitute.

Past iterations of EPCRS have permitted filers to submit anonymous correction filings to the Service through the Voluntary Correction Program (VCP). [Rev. Proc. 2019-19, § 10.09] Under the anonymous submission option, a plan sponsor could file a VCP anonymously through its representative. If the negotiations with the Service resulted in agreement as to the correction, the plan sponsor's identity was provided to the Service and it received a signed compliance statement from the Service as usual. If resolution could not be achieved, the plan sponsor had the option of withdrawing the submission, sacrificing only the VCP user fee in the process. This was a useful method for clarifying whether a proposed correction outside the examples in EPCRS would be acceptable, which was particularly valuable when

the normally acceptable correction is too expensive for the plan sponsor to use and it wishes to propose a creative, alternative solution. While the program was useful, it tended to take a significant amount of time for the Service to process such submissions, likely because so few of its agents were able to review them. Furthermore, if the Service spent the time and effort to analyze and negotiate the correction and the plan sponsor revoked the submission, that effort ended up being “wasted” (from the Service’s standpoint). As such, the Service is eliminating the program.

In its stead, the new Procedure permits a plan sponsor (again, through its representative), to anonymously engage in a pre-submission conference with the Service. [Rev. Proc. 2021-30, § 10.01] The pre-submission conference may be used to discuss matters on which a compliance statement may be issued (that is, the failure must fall under the umbrella of the Employee Plans group) and proposed correction methods that do not already exist in the safe harbor correction methods found in Appendices A and B to EPCRS. [Rev. Proc. 2021-30, § 10.01(1)] Based on the language in EPCRS, the representative will be required to file what is essentially a truncated VCP submission in its request for a conference. The filing, made with Form 8950, will include relevant facts, identify the failures, propose a method of correction, and provide the Service with any other information reasonably necessary to evaluate the proposal. [Rev. Proc. 2021-30, § 10.01(2)] Although these conferences offer a unique opportunity to discuss inventive solutions with the Service, the conference itself is neither memorialized by the Service in any writing, nor is it binding on the Service. [Rev. Proc. 2021-30, § 10.01(3)] Therefore, there is no opportunity to review a document that confirms the parties’ understanding of the conference discussions and, even if there were, the Service has the option of changing its mind when the ultimate VCP submission (which must follow the conference to qualify the plan’s correction) is filed.

The Service intends to update the instructions to Form 8950 to provide additional clarification on the procedure.

Extension of the Self-Correction Period

If you will forgive the intrusion of my personal beliefs, this is the change that most excites me. The self-correction program (SCP) under EPCRS is a magical tool. It permits a plan sponsor to bypass the formal

VCP process for many failures. SCP may be used to correct insignificant operational failures at any time and significant operational failures if corrected during the correction period. In previous versions of EPCRS, the correction period was defined as “the last day of the second plan year following the plan year for which the failure occurred.” [Rev. Proc. 2019-19, § 9.02(1)] For example, if a failure occurred in a calendar year plan in 2021, correction must be completed by December 31, 2023.

Effective with the most recent version of EPCRS, the correction period now extends until the last day of the third plan year following the plan year for which the failure occurred, granting plan sponsors an entire additional year in which to correct a significant operational failure. [Rev. Proc. 2021-30, § 9.02(1)] One year may not seem robust, but when you think of three years as roughly half of a restatement cycle, you may come to share my excitement.

Self-Correction by Plan Amendment

Appendix B of EPCRS has long provided certain specified situations in which an operational failure may be corrected by plan amendment that is retroactively effective to match plan terms to actual operations. The prior version of EPCRS in Rev. Proc. 2019-19 introduced a new option for this type of correction through SCP beyond the narrow parameters found in Appendix B (which applied in only three situations). Under Rev. Proc. 2019-19, to make use of self-correction, the amendment had to meet three requirements: (1) it resulted in an increase in a benefit, right, or feature; (2) the increase applied to all employees eligible to participate in the plan; and (3) providing the increase could not violate another section of the Code and had to satisfy the principles of EPCRS. [Rev. Proc. 2019-19, § 4.05(2)(a)] The second requirement caused the most consternation. What does it mean to apply to all employees eligible to participate? Could we consider the Code Section 401(k) portion of the plan separately from the Code Section 401(m) portion, or must we consider the plan as a whole? Without additional guidance, it was reasonably interpreted as a fairly restrictive requirement that prevented correction by amendment for any situation that involved fewer than all plan participants.

Rev. Proc. 2021-30 preserves the self-correction by plan amendment option, but eliminates the requirement that the increase apply to all eligible employees. [Rev. Proc. 2021-30, § 4.05(2)(a)] This opens the correction option greatly.

Example: The Mizuno Company has offices in Chicago, Toledo, and Sheboygan. It sponsors a retirement plan, the Mizuno Plan. The Mizuno Plan excludes the Sheboygan employees from participating in the Plan. For years, however, the human resources administrator has enrolled Sheboygan employees in the plan, the same as the other offices. The failure goes back to 2016 and affects 75 employees. The plan sponsor does not need to engage in any analysis of the significance of this failure nor does it need to file through VCP out of caution. The self-correction by plan amendment rules can be used to match the terms of the plan to actual operations, i.e., to not exclude the Sheboygan employees. Does this result in an increase in a benefit, right, or feature? Yes, the excluded employees, whom the document previously excluded, are now retroactively permitted to participate. Does it violate another section of the Code? So long as the corrections do not violate the Code Section 402(g) or the Section 415 limits (or cause the plan to fail nondiscrimination testing), no. Does it violate the principles of EPCRS? No –it is well in line with the principles of EPCRS as it is reasonable, appropriate, and keeps plan assets in the plan. [Rev. Proc. § 6.02(2)]

In spite of the helpful change, there exists still some vagueness and room for interpretation in this correction method. Tread lightly, but also consider what would be reasonable in the eyes of the Service.

Audit CAP Sanctions

Even if a plan is being investigated by the Service, there are opportunities to make corrections as part of that investigation. Such corrections are accomplished through the Audit Closing Agreement Program (Audit CAP) of EPCRS. Typically, in lieu of disqualifying the plan, the Service will assess a sanction that must be paid by the taxpayer to finalize the investigation and receive a signed closing agreement. Historically, such payments could be made to the Service via certified check or cashier's check. As a minor change, effective January 1, 2022, all Audit CAP sanctions will instead be paid through the Pay.gov website (the same website used by the Service for payment of VCP user fees). [Rev. Proc. 2021-30, § 13.02] Payments through Pay.gov may be paid with credit card, so at least you can get some rewards points out of your punishment.

Safe Harbor Correction for Automatic Contribution Arrangements

For many years, EPCRS has permitted a special safe harbor correction method for the failure to enroll a participant timely in a plan with an automatic contribution arrangement. The special correction method relieves an employer of the requirement to fund the Missed Deferral Opportunity, as defined in EPCRS, that would typically be required for an enrollment failure. Relief is granted if the failure is caught and corrected within 9½ months following the end of the plan year in which the failure occurred and the employer provides an appropriate notice, as dictated by EPCRS, to participants advising them of the failure and correction. [Rev. Proc. 2021-30, Appendix A.05(8)] The prior EPCRS contained this same correction option, but built a “sunsetting” feature into the guidance under which the option automatically expired on December 31, 2020. [Rev. Proc. 2019-19, Appendix A.05(8)(d)] The current EPCRS revives the safe harbor correction method, and it is now set to expire on December 31, 2023. [Rev. Proc. 2021-30, Appendix A.05(8)(d)]

As a point of interest, at the time of writing, Congress is currently considering the Securing a Strong Retirement Act of 2020, known informally as SECURE Act 2.0 (after the Setting Every Community Up for Retirement Enhancement Act of 2019 or the SECURE Act). One proposal included in SECURE Act 2.0 mandates automatic enrollment provisions in 401(k), 403(b), and SIMPLE IRA plans. It is possible that, if automatic contributions arrangements are mandated by the legislature, applicable correction methods could be addressed there, as well.

Taken together, the Service's most recent round of updates to EPCRS reflect a focus on realistic corrections methods and expectations for plan sponsors. The expansion of the self-correction period by a year demonstrates that, on the whole, plan sponsors are making use of SCP, and likely doing so appropriately. The coordination of overpayment correction methods with a defined benefit plan's funding requirement will help to reduce unnecessary expense on plan sponsors without negatively affecting the plan's balance sheet or the remaining participants. If the logic of words should yield to the logic of realities, this is the EPCRS of reality. ■

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