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IRS Modifies Employee Plans Compliance Resolution System

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To take advantage of the tax-favored benefits offered by retirement plans, plan sponsors and administrators must abide by the various requirements set forth in the Internal Revenue Code (Code). Failure to satisfy Code requirements in form or operation could lead to the devastating result of plan disqualification; however, the Internal Revenue Service (IRS) permits plan sponsors and administrators to fix their mistakes under the Employee Plans Compliance Resolution System (EPCRS) and subsequently avoid the repercussions of their failures. EPCRS encompasses three distinct correction programs: (1) the Self-Correction Program (SCP), which permits correction without IRS involvement or oversight; (2) the Voluntary Correction Program (VCP), which requires a filing fee and involves IRS oversight and approval; and (3) the Audit Closing Agreement Program (Audit CAP), which involves correction while under audit, a negotiated sanction with the IRS, and a closing agreement. EPCRS also provides certain IRS-approved correction methods for various document and operational failures.

Until recently, the EPCRS program guidelines were contained in Revenue Procedure 2019-19 (Rev. Proc. 2019-19); however, last week the IRS issued Revenue Procedure 2021-30 (Rev. Proc. 2021-30), modifying these guidelines and providing welcome changes benefiting plan sponsors, administrators, and participants alike. Specifically, Rev. Proc. 2021-30 modifies the previous guidelines by:

- expanding guidance on the recoupment of overpayments;
- eliminating the anonymous submission procedure under VCP;
- adding an anonymous, no fee, VCP pre-submission conference procedure;
- extending the end of the SCP correction period for significant failures from two to three years;
- expanding the ability of a plan sponsor to correct an operational failure under the SCP by retroactive plan amendment by removing the requirement that all participants benefit from the retroactive amendment;
- extending by three years the sunset of the safe harbor correction method available for correcting missed elective deferrals of eligible employees in plans with automatic contribution features; and
- increasing from $100 to $250 the threshold for certain de minimis amounts for which a plan sponsor is not required to implement a correction.

This article provides a high-level overview of the various changes provided in Rev. Proc. 2021-30 and how such changes could affect those seeking to take advantage of the EPCRS.

Expanded Overpayment Correction Methods for Defined Benefit Plans – Effective July 16, 2021

Rev. Proc. 2021-30 clarifies correction principals, modifies the prior correction methods to expand the options for recoupment of overpayments, and provides two new permissible methods of correcting overpayments (*i.e.,* payments that exceed the permitted payment amount under the plan terms) under defined benefit plans.

The new guidelines expand existing correction methods, which provide for recoupment of overpayment amounts, by allowing plan sponsors flexibility to provide participants or beneficiaries who have received overpayments (overpayment recipients) the option of repaying such overpayment in a single sum payment, through installment agreements, or through an adjustment in future payments.

Under the new "funding exception correction" method, corrective repayments are not required for a plan subject to Code Section 436 funding requirements if the plan's certified or presumed adjusted funding target attainment percentage determined at the date of correction is equal to at least 100%. While the future benefit payments to an overpayment recipient must be reduced to the correct benefit payment amount, no further corrective payments or reductions to future benefit payments are permitted.

Under the new "contribution credit correction" method, the overpayment that must be repaid to the plan is a reduced amount equal to the overpayment reduced (but not below zero) by a "contribution credit" of:

(A) the cumulative increase in the plan's minimum funding requirements attributable to the overpayments beginning with (1) the plan year for which the overpayments are taken into account for funding purposes through (2) the end of the plan year preceding the plan year for which the corrected benefit payment amount is taken into account for funding purposes; and

(B) certain additional contributions in excess of minimum funding requirements paid to the plan after the first of the overpayments was made.

If, after applying the contribution credit, the overpayment amount is reduced to zero, no further corrective payments from any party are required, and no further reductions to future benefit payments are permitted. However, if a net overpayment remains after the application of the contribution credit, the plan sponsor or other party must take further action to reimburse the plan for the remainder of the overpayment.

Anonymous VCP Submissions and Pre-Submission Conferences – Effective January 1, 2022

Rev. Proc. 2021-30 eliminates anonymous VCP submissions but adds an anonymous pre-submission procedure. Currently, plan sponsors can file a VCP submission anonymously with payment of a filing fee in accordance with EPCRS's anonymous VCP procedures. However, effective January 1, 2022, the IRS will no longer accept anonymous VCP submissions but will replace this procedure with a new, optional anonymous pre-submission conference procedure. Under the new procedure, plan sponsors may make anonymous written requests to the IRS for a pre-submission conference to discuss a potential VCP submission at no cost to the plan sponsor;

however, once a plan sponsor files a VCP submission with the IRS following the conference (with the requisite filing fee), anonymity is lost.

Correction Period for Significant Operational Failure – Effective July 16, 2021

Rev. Proc. 2021-30 also extends the end of the SCP correction period for significant failures by one year. Under prior guidance, correction of a significant operational failure under SCP (without IRS involvement or oversight) must be completed before the last day of the second plan year following the plan year in which the failure occurred (self-correction period). Effective July 16, 2021, Rev. Proc. 2021-30 extends the self-correction period to permit plan sponsors to make corrections of significant failures until the last day of the third plan year following the plan year in which the failure occurred. This extension has, in turn, extended the safe harbor correction method for employee elective failures lasting more than three months. The IRS provides modified examples to reflect the new, extended correction period in the recently issued guidance.

Self-Correction for Retroactive Plan Amendments – Effective July 16, 2021

Historically, self-correction of operational errors by retroactive amendment conforming the terms of the qualified plan or 403(b) plan to its prior operations was limited to certain specific failures outlined in EPCRS, meaning that, in most cases, correction by adoption of a retroactive amendment required a VCP submission with IRS approval. Rev. Proc. 2019-19 (the prior iteration of EPCRS) expanded the ability to self-correct by retroactive amendment if the amendment resulted in an increase of a benefit, right, or feature that applied to *all employees eligible to participate* in the plan, in conjunction with certain other requirements. Where only a portion of the employees eligible to participate were affected by the retroactive amendment, self-correction under this guidance was not permitted. In an effort to expand the ability of self-correction by retroactive amendment, Rev. Proc. 2021-30 removes the requirement that *all* participants benefit by the retroactive amendment, effective July 16, 2021.

Automatic Enrollment Failures – Effective January 1, 2021

Rev. Proc. 2021-30 extends the favorable safe harbor correction method for elective deferral failures in 401(k) and 403(b) plans that contain automatic contribution features by three years, until December 31, 2023. Under the safe harbor correction, if certain requirements are met, the plan sponsor need not make any corrective contribution with respect to missed elective deferrals but must make a corrective contribution for any missed match (adjusted for earnings). The extension is retroactive to January 1, 2021, meaning that elective deferral failures that occurred after the December 31, 2020 sunset or occur through December 31, 2023 and otherwise meet the requirements for the safe harbor correction may take advantage of the favorable safe harbor correction method.

De Minimis Correction Amounts – Effective July 16, 2021

EPCRS permits plan sponsors to forgo making certain corrections if the amount of the correction is considered “de minimis.” For errors that involve overpayments or excess amounts, Rev. Proc. 2021-30, increases the “de minimis” threshold from $100 to $250. As such, plan sponsors are not required to seek repayment from an overpayment recipient provided that the overpayment does not exceed $250. The plan sponsor is also not required to notify such affected participant or beneficiary that the overpayment is ineligible for favorable tax treatment afforded to plan distributions (including tax-free rollover). In addition, plan sponsors are not required to

distribute or forfeit excess amounts with respect to a participant or beneficiary that does not exceed $250, except that if the excess amount exceeds statutory limits, the plan sponsor must notify the affected participant or beneficiary that the excess amount, including investment earnings, is ineligible for favorable tax treatment afforded to plan distributions (including tax-free rollover). The “de minimis” exceptions apply to both defined contribution and defined benefit plans.

Conclusion

Rev. Proc. 2021-30 provides greater flexibility to plan sponsors seeking to correct certain plan-related failures and eliminates some of the hurdles under prior EPCRS guidelines. However, as the intricacies of EPCRS can be difficult to navigate, plan sponsors should consult with experienced benefits counsel to assist them following a plan failure to avoid plan disqualification.

For assistance in evaluating how these changes may affect your qualified plan, please contact a member of Troutman Pepper Hamilton Sanders LLP’s Employee Benefits and Executive Compensation team.

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