buckconsultants

FYI®
For Your Information®

Volume 38 | Issue 48 | April 2, 2015

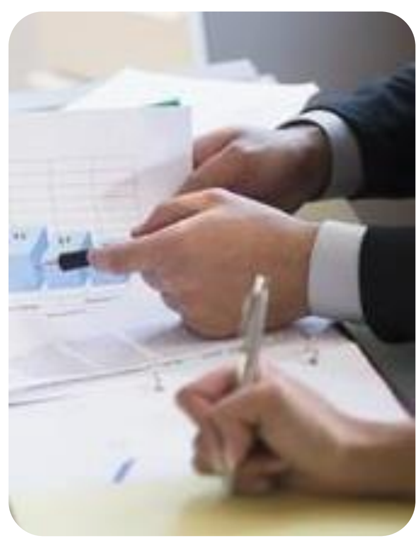
IRS Modifies Retirement Plan Correction Procedure

The IRS has modified its retirement plan correction procedure, responding to the practical needs of employers trying to keep their pension plans in operational compliance without excessive cost for the plan sponsor or imposing undue hardship on plan participants.

Background

Well before its 1998 consolidation of retirement plan correction programs into the Employee Plans Compliance Resolution System (EPCRS), the IRS encouraged plan sponsors to make voluntary and timely correction of plan failures to maintain the qualified status of their plans. Plan sponsors rely upon the EPCRS procedure as a guide to saving the tax-favored status of their plans when jeopardized by any failure to follow the terms of the plan or the Internal Revenue Code. Over the years, the IRS has periodically updated EPCRS to reflect changing circumstances and make other improvements. The most recent version of EPCRS was issued in Revenue Procedure 2013-12.

Under EPCRS, plan sponsors have encountered a conundrum when faced with certain corrections. In some cases, the IRS correction fee is based on the number of plan participants, making a large employer with a small error weigh the risks of not filing the correction with the IRS. In other cases, the proposed correction may have imposed a hardship on plan participants — a factor highlighted recently in the press.



Reduced Fees, Emphasis on Flexibility, and Operational Changes to EPCRS

In Revenue Procedure 2015-27, the IRS has considered these issues and modified Revenue Procedure 2013-12 accordingly. In addition to addressing fees and overpayments, the modifications provide additional time for certain corrections and make technical adjustments. Still missing, however, are certain other changes requested by benefits practitioners.

Overpayments

Under the correction procedure, when plan participants and beneficiaries receive more benefits than they are entitled – regardless of the cause of the error – one method of correction is for the employer to take reasonable steps to have the overpayment (with earnings) returned to the plan. Another method for defined benefit plans is to reduce the amount of future payments by the amount necessary to recover the overpayment and earnings over the payee's remaining life expectancy.

However, in some cases, large repayments due to errors discovered after many years would cause financial hardship for aged participants and beneficiaries. Plan sponsors sometimes told those participants and beneficiaries that full repayment was required by the IRS, despite DOL Advisory Opinion 77-08's support for plan fiduciaries who decide not to pursue recoupment because doing so may impose a hardship. Apparently, it was not clear that IRS qualification rules would allow the fiduciary to invoke this judgment.

Litigation and Reputational Risk

In addition to a concern that a recoupment may impose a hardship on retirees, plan sponsors may want to consider the potential costs associated with litigation and reputational risks. Though many courts have supported the rights and obligations of a plan to limit benefits to the amount defined under the terms of the plan, ambiguities and misrepresentations have led some courts to rule against plans attempting to recoup overpayments.

Revenue Procedure 2015-27 clarifies that employers have flexibility in correcting these overpayment failures. Depending on the facts and circumstances, demanding repayment may not be necessary if the employer or another person (such as the service provider that made the error, if applicable) contributes the amount of the overpayment (plus interest) or if the plan sponsor amends the plan retroactively to conform to the plan's operations.

> **Comment.** IRS did not change the limited ability to use a plan amendment for corrections without obtaining IRS approval; revising the plan to conform to a plan overpayment is only available with IRS involvement — not to self-correction.

The IRS would like comments on the circumstances, if any, in which employers should be *required* to make the plan whole for overpayments due to benefit calculation errors instead of requesting repayment by participants and beneficiaries. IRS also asks if requests for repayment should be limited as specified in the PBGC's recoupment regulations. And, is additional guidance needed for calculating interest on overpayments due to benefit calculation errors.

Reduced IRS Compliance Fees

The IRS has lowered its compliance fees for certain submissions for minimum distribution and loan-related failures.

Required minimum distributions — A reduced fee of $500 is available for minimum distribution failures involving up to 150 participants, and a reduced fee of $1,500 is available for failures involving 151 to 300 participants. Previously, a reduced fee of $500 was available for a minimum distribution failure involving 50 or fewer participants. As was the case previously, if the number of participants affected exceeds these thresholds, the general compliance fee schedule based on the number of participants applies.

Participant loans — A reduced fee applies, ranging from $300 for 13 or fewer failures to $3,000 for over 150 failures — if the only failure involves loan failures that affect 25% or fewer participants in any year. Previously, the reduced fee was 50% of the general compliance fee based on number of plan participants — regardless of the number of participants whose loans needed to be corrected.

> **Comment.** Self-correction of loan failures is still not available under EPCRS. Plan sponsors had asked for the ability to self-correct loan failures so they could avoid a formal filing for problems that are somewhat commonplace.

Self-Correction of Excess Annual Additions to Defined Contribution Plans

The amount that may be contributed (both employer and employee) to participants' accounts in defined contribution plans is limited on an annual basis. Plans that only allocate elective deferrals and non-elective contributions are permitted to routinely refund elective deferrals to fix breaches of this limit. The timeframe to distribute these excess deferrals to participants has been increased from 2½ months to 9½ months after the end of the plan's limitation year, giving plan sponsors a longer period to test and correct these errors.

> **Comment.** Although the additional time is welcome, the EPCRS rule is still of limited use given the narrow group of plans that merely provide elective deferrals and nonelective contributions — but not matching contributions.

Required Determination Letter Applications

For situations that require plan amendments to implement a correction, IRS generally requires submission of a determination letter request as a part of the correction. The new revenue procedure clarifies that a plan sponsor is not required to submit a determination letter application when amendments are made to IRS pre-approved plans that would not cause the plan to lose reliance on the pre-approved plan's advisory or opinion letter. Similarly, it is not necessary to submit an application for amendments to terminated plans that distributed substantially all plan assets more than 12 months earlier.

Expanded Correction Period for Adopting Amendments

An employer that is required to submit a determination letter application with a correction filing for an amendment that is not a failure to adopt a good faith, interim, or optional law change amendment has until the later of 150 days after the compliance statement or 91 days after a favorable determination letter is issued to adopt the corrective amendment. Good faith, interim, and optional law change amendments still must be adopted and included in the submission.

Submission Forms

Appendix C (model submission documents) and Appendix D (IRS Acknowledgement Letter) of Revenue Procedure 2013-12 have been removed and replaced by specific IRS forms.

In Closing

The IRS has taken a few important steps towards encouraging plan sponsors to correct plan errors by removing the sting from the corrections – whether by reducing IRS fees, providing leeway in correcting overpayments, or expanding the correction period. Notably still missing are responses to requests for self-correction of loan failures and more flexible automatic enrollment corrections.

Volume 38 | Issue 48 | April 2, 2015

Authors
Joanne Jacobson, JD, LLM
Fred Farkash, CEBS, Fellow-ISCEBS

Produced by the Knowledge Resource Center of Buck Consultants at Xerox
The Knowledge Resource Center is responsible for national multi-practice compliance consulting, analysis and publications, government relations, research, surveys, training, and knowledge management. For more information, please contact your account executive or email fyi@xerox.com.

You are welcome to distribute *FYI*® publications in their entireties. To manage your subscriptions, or to sign up to receive our mailings, visit our Subscription Center.

This publication is for information only and does not constitute legal advice; consult with legal, tax and other advisors before applying this information to your specific situation.