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Internal Revenue Service Updates the Employee Plans Compliance Resolution System under Revenue Procedure 2021-30

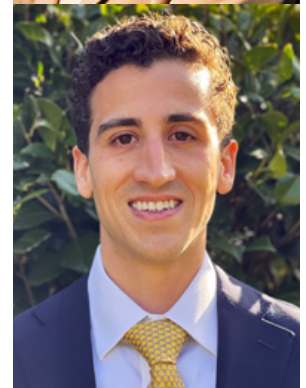
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NICOLAS DEGUINES

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On July 16, 2021, the Internal Revenue Service (IRS) released Revenue Procedure 2021-30, an updated version of the Employee Plans Compliance Resolution System (EPCRS), which we will refer to in this article as the "EPCRS Update." This article summarizes the significant changes and revisions made by the IRS under the EPCRS Update.

Expanded Guidance on the Correction of Overpayments and Excess Amounts from Qualified Plans

One of the most significant changes reflected in the EPCRS Update relates to the rules governing the correction of "overpayments" and "excess amounts" from qualified plans. In general, EPCRS defines "overpayments" as qualification failures due to a payment being made to a participant or beneficiary that exceeds the amount payable to the recipient under the terms of the qualified plan (or that exceeds a limitation provided in the Internal Revenue Code of 1986, as amended ["Code"] or regulations thereunder). EPCRS defines "excess amounts" as qualification failures due to a contribution, allocation, or similar credit that is made on behalf of a participant or beneficiary to a qualified plan in excess of the maximum amount permitted to be contributed, allocated, or



credited on behalf of the participant or beneficiary under the terms of the plan (or that exceeds a limitation on contributions or allocations provided in the Code or regulations). EPCRS describes certain permissible methods for correcting overpayments and excess amounts. The EPCRS Update modifies and clarifies these methods and creates two new methods for correcting overpayments from defined benefit plans, as outlined below.

Increase in De Minimis Corrections Thresholds

The EPCRS Update increases the thresholds for certain *de minimis* amounts for which a plan sponsor is not required to make full correction. Specifically, the *de minimis* thresholds for overpayments and excess amounts have increased from \$100 to \$250. As a result of this change:

- if the total excess amount contributed, allocated or credited to a recipient is \$250 or less, the plan sponsor is not required to distribute or forfeit the excess amount (however, if the excess amount exceeds a statutory limit, the recipient must be notified that the excess amount and any investment gains are not eligible for tax-free rollover); and
- if the total overpayment made to a recipient is \$250 or less, the plan sponsor is not required to seek the return of the overpayment from the recipient nor is it required to notify the recipient that the overpayment was not eligible for tax-free rollover.

Updates and Clarifications on Overpayment Methods

The EPCRS Update also clarifies that when a qualification failure is eligible for the *de minimis* thresholds described above, the plan sponsor is not required to make a corrective contribution to the plan.

In addition, the EPCRS Update provides that when a plan sponsor is seeking recoupment of an overpayment from an overpayment recipient (e.g., the participant or beneficiary who received the overpayment amount), the plan sponsor may provide the overpayment recipient with the option of repaying the overpayment in a single sum payment; or by entering into an installment agreement; or, in the case of a defined benefit plan, through an adjustment to future benefit payments.

Under the “adjustment to future benefit payments” method, the recipient’s future payments from the plan are reduced to recoup the overpayment over a period that does not exceed the remaining payment period, so that the actuarial present value of the reduction is equal to the overpayment, plus interest (at the interest rate used by the plan to determine actuarial equivalence). If the overpayment is being corrected using the adjustment in future payments method and the amount returned by an overpayment recipient is less than the total overpayment (e.g., due to the death of the recipient), the EPCRS Update provides that the plan sponsor is not required to contribute any additional amount to the plan, which is a welcome clarification.

New Defined Benefit Overpayment Correction Methods

The EPCRS Update also provides two new correction methods for overpayments from defined benefit plans, namely the “funding exception correction” method and the “contribution credit correction” method.

Funding Exception Correction Method:

Under this method, no corrective payments (either from the overpayment recipient, the plan sponsor or any other party) are necessary for the overpayment if the plan’s certified or presumed Adjusted Funding Target Attainment Percentage (AFTAP) as of the date of correction is at least equal to 100% (or in the case of a multiemployer plan, the plan is not in critical, critical and declining, or endangered status as of most recent annual funding certification). When this method is used, any future periodic payments to an overpayment recipient must be reduced to the correct amount, but no further benefit reductions or corrective payments from an overpayment recipient (or any spouse or beneficiary of the recipient) or any other party are permitted.

Contribution Credit Correction Method:

Under this method, the overpayment amount that is required to be repaid to the plan is reduced by a “contribution credit,” which is determined as (A) plus (B):

- (A) The cumulative increase in the plan’s minimum funding requirements attributable to the overpayment amounts (including the increase attributable to the overstatement of liabilities, whether funded

through cash contributions or through the use of a funding standard carryover balance, prefunding balance, or funding standard account credit balance) beginning with (1) the plan year for which the overpayment amounts 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. (In other words, an overpayment amount does not need to be contributed separately to the plan to the extent it has already been reflected in an increase in the required minimum funding contributions.)

(B) Certain additional contributions in excess of minimum funding requirements paid to the plan after the first of the overpayment amounts were made. However, contributions may not be counted toward the contribution credit if they are designated for other plan purposes, specifically, as (1) contributions added to the plan's prefunding balance (except if an election is made by the date of correction to reduce the prefunding balance by all or a portion of those corrections); (2) contributions made to avoid or remove funding-based restrictions under Code Section 436; (3) contributions made to Cooperative and Small Employer Charity (CSEC) plans and withdrawal liability payments and other contributions made to multiemployer plans (which are all automatically added to the credit balance); and (4) contributions made to correct other qualification failures under EPCRS.

For purposes of the calculation above, the amounts of overpayments and the cumulative additional contributions (taking into account the increase in minimum funding and excess contributions) are determined without adjustment for interest.

If the total amount of the overpayment is reduced to zero after the contribution credit is applied, then no further benefit reductions or corrective payments from an overpayment recipient (or any spouse or beneficiary of a recipient) or any other party are permitted, although future benefit payments must still be reduced to the correct amount.

However, if a net overpayment amount remains after the contribution credit is applied, the plan sponsor or another

party must take further action to reimburse the plan for the remainder of the overpayment amount. If the plan sponsor seeks recoupment from the overpayment recipient, as opposed to making a single sum contribution to the plan, the overpayment recipient must be given the option of repaying the overpayment amount in a single lump sum, through an installment agreement or through the adjustment of future payments. To the extent the amount returned by the overpayment recipient through a single sum payment or an installment agreement is less than net overpayment amount, the plan sponsor or another party must contribute any additional amount owed to the plan. However, if the overpayment recipient is not able to return the net overpayment through adjustment of future payments (e.g. due to death of the overpayment recipient), the plan sponsor is not required to contribute any additional amount to the plan.

If the plan sponsor requests recoupment of the remainder of the overpayment from the overpayment recipient, a written notice containing required information must be provided to the individual. This notice must indicate that if the overpayment recipient does not choose a repayment option within 30 days, the default correction will be the adjustment of future payments method (if the overpayment recipient is entitled to future payments) or a single sum repayment (if the overpayment recipient is not entitled to future payments).

If the overpayment recipient chooses to have future periodic benefit payments adjusted, then the maximum adjustment must be limited to 10% of the corrected benefit amount, interest cannot accrue prior to the date that corrected payments begin, and appropriate interest must accrue beginning on the date that corrected payments begin.

If the overpayment recipient chooses to repay the amount through an installment agreement, then interest may not accrue prior to the date that installment payments begin, appropriate interest must accrue beginning on date installment payments begin, and the installment period must be at least 5 years.

TH COMMENT: Overall, we believe that these are meaningful improvements which should simplify the overpayment correction process for plan sponsors and service providers.

Elimination of the Anonymous Submission Process

Another significant change reflected in the EPCRS Update is the elimination of the anonymous submission process. Specifically, the ability of plan sponsors to submit Voluntary Correction Program (VCP) applications on an anonymous basis (only providing identifying information once the plan sponsor and the IRS come to an agreement on the correction method) will be eliminated effective January 1, 2022.

In lieu of the anonymous VCP submission process, the EPCRS Update provides (effective January 1, 2022) that prior to submitting a VCP application to the IRS, a plan sponsor's representative may request an "anonymous no-fee VCP pre-submission conference" with the IRS. The EPCRS Update provides that the anonymous no-fee VCP pre-submission conference may be requested only (1) for matters on which a compliance statement may be requested under EPCRS, (2) with respect to correction methods that are not described as safe harbor correction methods under EPCRS, and (3) if the plan sponsor is eligible and intends to submit a VCP. Under the EPCRS Update, the anonymous no-fee VCP pre-submission conference request should describe the failure and all relevant facts, including the type of affected participants, identify the proposed method of correction, include all plan provisions and amendments relevant to the request, and include "any other information the IRS would need to evaluate the request."

The EPCRS Update further provides that the anonymous no-fee VCP pre-submission conference will be held at the discretion of the IRS "if time permits." If the IRS agrees to meet with the plan sponsor's representative, at the conference the IRS will provide the representative with oral feedback regarding the failure and proposed correction method. However, the EPCRS Update states that any discussion of substantive issues at the conference will be advisory only and not binding on the IRS (meaning that it cannot be relied upon by the plan sponsor). After the conference, the IRS will provide only a written confirmation that the conference took place, and the matter will be closed.

TH COMMENT: We note that while the anonymous VCP process did not provide audit protection until the plan

sponsor's identity was revealed, it did provide plan sponsors with comfort since they were able to disclose errors to the IRS anonymously without concern that the VCP could lead to the imposition of an unreasonable correction method or open the door to an IRS plan examination. Plan sponsors who wish to take advantage of the anonymous VCP process must get their submissions filed by December 31, 2021.

Extension of Self-Correction Period for Significant Failures

Under EPCRS, failures that are considered "significant" (based on facts and circumstances, as described in EPCRS) are only eligible for the Self-Correction Program (SCP) during a specific correction period. The EPCRS Update extends the SCP correction period for significant failures by one year. As a result, the SCP correction period now ends on the last day of the third (increased from the second) plan year following the plan year for which a failure occurred. For example, if a significant failure occurs during the 2021 plan year, the SCP correction period for this significant failure now ends on December 31, 2024 (it previously ended on December 31, 2023). This extension applies to the self-correction of both significant operational and plan document failures.

Additionally, the extension of the SCP correction period also applies to the EPCRS correction method relating to certain missed deferral opportunities. Specifically, under EPCRS, if a qualified plan fails to implement an employee's elective deferral election or fails to provide an employee with the opportunity to make an affirmative election, and the period of the failure lasts longer than 3 months but not past the SCP correction period, the plan sponsor can correct the failure by making a reduced 25% Qualified Nonelective Employer Contribution (QNEC) for the missed deferral opportunity (provided that certain timing and notice requirements are satisfied and the other requirements under EPCRS are followed). This is one of the few safe harbor correction methods under EPCRS for missed deferral opportunities that extends beyond 3 months. As a result of the extension of the SCP correction period described above, the 25% QNEC under this safe harbor will now be available for missed deferral opportunities that are corrected within 3 years of the end of the plan year that included the initial failure.

TH COMMENT: We believe this is a great improvement which will give plan sponsors and service providers more time to identify and self-correct plan failures.

Extension of Safe Harbor Correction Method for Certain Automatic Enrollment Failures

EPCRS previously contained a safe harbor correction method for certain automatic enrollment features. Under this safe harbor, the failure to properly implement automatic enrollment under a qualified plan (or the failure to implement an affirmative election of an employee otherwise subject to automatic enrollment under a qualified plan) could be self-corrected without any QNECs for the missed deferral opportunity if certain notice and timing requirements were satisfied (and additional conditions were met, as described in EPCRS). However, this safe harbor correction method was only available until December 31, 2020. The EPCRS Update revives the automatic enrollment safe harbor correction method effective January 1, 2021, and extends the availability of this safe harbor through December 31, 2023.

TH COMMENT: We believe this is another great improvement which will grant plan sponsors and service providers more time to identify and self-correct automatic enrollment failures without significant costs.

Expansion of Ability to Self-Correct Operational Failures by Plan Amendment

EPCRS provides that operational errors (the failure to operate a qualified plan in accordance with its terms) may be self-corrected through the adoption of a retroactive plan amendment to make the terms of the plan conform to actual operation *if* certain conditions are satisfied. The EPCRS Update expands these conditions, as follows:

1. The plan amendment would result in an increase of a benefit, right, or feature; and

2. The provision of the increase in the benefit, right, or feature to participants is permitted under the Code and satisfies the correction principles of EPCRS and other rules.

Prior to the EPCRS Update, EPCRS required that the increase of a benefit, right, or feature apply to all employees eligible to participate in the plan.

TH COMMENT: As a result of this change, we believe plan sponsors and service providers will have expanded flexibility to self-correct operational errors by adopting a retroactive plan amendment. This is a welcome change.

Effective Date

Except as otherwise described above, the changes made by the EPCRS Update are generally effective July 16, 2021.

Conclusion

Overall, the EPCRS Update is good news for plan sponsors and employers. By expanding the SCP correction period, providing additional overpayment correction methods (especially for defined benefit plans), increasing the *de minimis* correction threshold, and extending the automatic enrollment safe harbor correction method, it is clear that the IRS is taking steps toward more self-correction by plan sponsors (and fewer formal submissions to the IRS under VCP). Given the complexity of operating qualified plans, plan failures are an unfortunate reality. The EPCRS Update demonstrates the IRS's consistent effort to understand that reality and provides plan sponsors with a corrections landscape that meets their needs.

As your benefits attorneys, we will continue to monitor developments in plan corrections and provide you with meaningful updates. Please contact us if you have any questions about the EPCRS Update or any concerns regarding your retirement plan.

The Trucker ♦ Huss Benefits Report is published monthly to provide our clients and friends with information on recent legal developments and other current issues in employee benefits. Back issues of *Benefits Report* are posted on the Trucker ♦ Huss web site (www.truckerhuss.com).

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