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SECURE 2.0 – Impact on Correction Principles

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Agenda

- Expansion of EPCRS
  - Expansion of Self-Correction
  - Application to IRAs
  - Plan Loan Failures
- Recovery of Plan Overpayments
- Codification of Automatic Enrollment Corrections
- Reduced Excise Tax for Late RMDs
- Extension of Plan Amendment Deadline

EXPANSION OF THE EMPLOYEE PLANS COMPLIANCE RESOLUTION SYSTEM (EPCRS)

Background on EPCRS

- The Employee Plans Compliance Resolution System (EPCRS) is an Internal Revenue Service (IRS) program that allows plan sponsors to correct disqualifying defects with respect to their retirement plans
- Most recent version: Revenue Procedure 2021-30
- EPCRS includes Voluntary Correction Program (VCP), Audit Closing Agreement Program (Audit-CAP), and the Self-Correction Program (SCP)

Background on EPCRS

- SCP can only be used to correct certain Operational Failures and Plan Document Failures
- Eligibility for SCP requires practices and procedures
- Significant failures must be corrected by end of <u>third</u> plan year after year of the defect, and before notice of an IRS exam
- Insignificant failures may be corrected at any time

Background on EPCRS

- Plan sponsors that utilize SCP generally should correct errors in accordance with the IRS approved correction methods or at a minimum the general correction principles
- Examples include:
  - Exclusion of eligible employees
  - Failure to timely distribute excess deferrals
  - Overpayments
  - Retroactive amendment of certain operational errors

SECURE 2.0 Expansion of SCP

- Effective immediately, any "eligible inadvertent failure" to comply with Code section 401(a), 403(a), 403(b), 408(p), or 408(k) may be corrected under SCP unless:
  - Such failure was identified by the IRS prior to any actions which demonstrate a specific commitment to implement a self-correction, or
  - The self-correction is not completed within a reasonable period after such failure is identified

SECURE 2.0 Expansion of SCP

- The correction period for significant failures is <u>indefinite and has no last day</u>
- The correction method used must be in conformity with the principles set forth in Revenue Procedure 2021-30 (or any successor guidance)
- The IRS is directed to update Revenue Procedure 2021-30 within two years

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SECURE 2.0 Expansion of SCP

- This means the following:
  - Significant failures can now be corrected regardless of when they occurred
  - Eligibility for SCP is determined based on when the error is discovered and not when it occurred
  - Significant failures can now be corrected if plan is under IRS exam if not identified and sponsor can show commitment to correct
  - SCP now applies to SEPs and SIMPLE IRAs
  - Correction must be in conformity with EPCRS

SECURE 2.0 Expansion of SCP

- An "eligible inadvertent failure" is a failure that occurs despite the existence of practices and procedures reasonably designed to facilitate overall compliance with the qualified plan rules
- It does not include any failure which is egregious, relates to a diversion or misuse of plan assets, or is directly or indirectly related to an abusive tax avoidance transaction
  - Note: These are already excluded from SCP

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SECURE 2.0 Expansion of SCP

- Some questions include the following:
  - Do the new SCP rules apply to errors that occurred prior to the enactment of SECURE 2.0?
  - What is scope of this expansion, and will the IRS add to the types of corrections available under SCP?
  - What is a reasonable period to implement the correction and if fail to meet, what are the consequences? Do the old SCP timing rules apply?
  - What do plan sponsors do now if they have a failure and are considering a correction method not approved under Revenue Procedure 2021-30?

SECURE 2.0 Expansion of SCP

- Some questions include the following:
  - Will there be any changes to VCP considering SCP expansion?

EPCRS for IRAs

- Prior to SECURE 2.0, individual retirement accounts (IRAs) were not eligible for correction under SCP, VCP or Audit-CAP
- SECURE 2.0 directs the Secretary to expand EPCRS to allow custodians of IRAs to address eligible inadvertent failures with respect to IRAs, including:
  - Waivers of the excise tax under Code section 4974; and

EPCRS for IRAs

  - Rules permitting a non-spouse beneficiary to return distributions to an inherited IRA when they made erroneous rollovers
- The scope will not be known until Revenue Procedure 2021-30 is updated

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PARTICIPANT LOANS

Participant Loans – Background

- Historically, correction of most participant loan failures had to be submitted under the EPCRS Voluntary Correction Program (VCP) in order to prevent the loan from defaulting and being treated as a deemed distribution
- Over the last five years, the IRS has evolved on plan loan failures, expanding the ability to correct without seeking service approval (without filing under VCP)
- SECURE 2.0 provides additional self-correction relief for plan loan failures as part of the overall expansion of self-correction of eligible inadvertent failures

Participant Loans – Background

- Under Revenue Procedure 2021-30, certain participant loan failures are eligible for self-correction:
  - Defaulted Loan Due to Missed Loan Payments, where the participant is willing to fix the default and the employer is willing to make-up for additional unpaid interest during the missed payment period. Correction involves a catch-up payment and/or reamortization of the loan (subject to maximum loan term). This self-correction avoids loan default and deemed distribution
  - Defaulted Loans Due to Missed Loan Repayments where the sole request is to report the loan as a deemed distribution in the year of correction instead of the year of the failure

Participant Loans – Background

- Failure to Obtain Spousal Consent, where the spouse is willing to provide retroactive consent for the loan
- Loan Exceeds Plan Limit on Loans, where the plan sponsor is willing to adopt a retroactive amendment to the plan (compliant with Code section 401(a)) to conform the written plan document to the plan's operation. To be eligible for self-correction, the excess loans must have been available to all participants, or solely to one or more NHCEs
- Loan Does Not Meet Statutory Requirements Under Code Section 72(p) (loan terms were for more than the applicable loan limit or repayment period), where the sole request is to report the deemed distribution in the year of correction instead of the year of the failure

Participant Loans and SECURE 2.0

- The definition of "Eligible Inadvertent Failure" is broad, and includes failures related to plan loans. Congress provided specific relief with respect to two key plan loan failure considerations:
  - (1) Deemed Distribution Relief. SECURE 2.0 provides relief from having to report corrected deemed distributions on Form 1099-R. Previously, a VCP application was required to not report a corrected loan failure on Form 1099-R where the loan was in excess of the applicable limit (generally $50,000) or the maximum repayment term (generally five years)
  - (2) Correction of Fiduciary Breach. Where a participant loan failure also amounts to a fiduciary breach, SECURE 2.0 directs the Department of Labor (DOL) to treat self-corrected loan failures as meeting the requirements of the voluntary Fiduciary Correction Program (VFCP), so long as the loan is corrected in accordance with EPCRS

Participant Loans and SECURE 2.0

- Participant loans failing to comply with Plan provisions for the amount, duration or level amortization requirements are a breach of fiduciary duty. Such a breach eligible for correction under the DOL VFCP, the application requirement for which include submitting a compliance statement from the IRS with respect to the correction of the loan failure (thus requiring a VCP). SECURE 2.0 makes it clear that the DOL may no longer require a VCP / compliance statement
- Plan fiduciaries remain responsible for the 15% excise tax associated with the breach of fiduciary duty. It remains unclear what other reporting or procedural requirements the DOL may continue to impose for purposes of VFCP

Participant Loans and SECURE 2.0

- Summary Conclusion of Impact of SECURE 2.0 on Loans:
  - Participant loans may now be more broadly self-corrected, including loans that exceed the applicable dollar limit, do not satisfy the level amortization requirement, or maximum repayment terms
  - Self-correction assumes the plan sponsor / plan fiduciaries will use traditional correction methods. Loan corrections involving alternative correction proposals may still need to be submitted under VCP
  - Further guidance is anticipated from the IRS in an updated version of EPCRS
  - Further guidance is anticipated from the DOL with respect to correction of participant loans that constitute a fiduciary breach

RECOVERY OF OVERPAYMENTS

Background on Plan Overpayments

- Retirement plans sometimes mistakenly pay participants or beneficiaries more money than they are owed, which results in a qualification failure
- EPCRS includes various approved methodologies for correcting overpayments made from defined benefit and defined contribution plans
- In certain circumstances, EPCRS permits plan sponsors to correct overpayment failures without seeking to recoup an overpayment from the participant or beneficiary
  - However, under EPCRS, the plan sponsor or another person must generally contribute to the plan any overpayment amounts that are not repaid to the plan

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SECURE 2.0 Changes

- Under SECURE 2.0, effective immediately, retirement plan fiduciaries have the discretion not to seek recovery of overpayments
- If plan fiduciaries choose to recover overpayments, SECURE 2.0 imposes certain limitations and protections on the amount and manner of the recoupment in order to protect participants

Overpayment Relief under the Code

- SECURE 2.0 amends the Code to provide that a plan will not lose its qualified status merely because:
  - it fails to recover an inadvertent benefit overpayment; or
  - it amends the plan to increase past benefits or decrease future benefit payments to the affected participants and beneficiaries
- A plan sponsor must, however, observe any limitations imposed by Code section 401(a)(17) and Code section 415. And the IRS is authorized to provide guidance on how these limits are enforced in connection with recouping benefit payments, as well as satisfying other qualified plan requirements

ERISA Fiduciary Relief

- Changes were also made to ERISA to specify that, in the case of an inadvertent overpayment, a plan fiduciary shall not fail to satisfy its duties under ERISA merely because such fiduciary determines not to seek recovery of all or part of an overpayment from a participant or beneficiary
- Similar relief is also available for a decision not to seek recoupment from a plan sponsor, contributing employer, or other fiduciary, subject to certain conditions

Limitations on Fiduciary Relief

- If a fiduciary decides not to seek recovery from a plan sponsor or contributing employer:
  - SECURE 2.0 does not relieve a plan fiduciary from recovering any amounts necessary to restore an impermissible forfeiture from a participant's or beneficiary's account under a defined contribution plan
  - Further, the failure to recoup inadvertent overpayments may not adversely affect the ability of a defined benefit plan to pay benefits due to other participants and beneficiaries

Limitations on Fiduciary Relief

- A fiduciary (e.g., a plan sponsor acting in a fiduciary capacity) is not relieved from responsibility for an overpayment that resulted from a breach of its fiduciary duties
  - But if a plan has established prudent procedures to prevent and minimize overpayments and the fiduciaries of the plan have followed such procedures, an inadvertent benefit overpayment will not be a breach of fiduciary duty
- And in no event does SECURE 2.0 relieve a plan sponsor from satisfying a plan's minimum funding requirements

Limitations on Ability to Recover Overpayments

- Effective immediately, if a plan fiduciary decides to recover overpayments from a participant or beneficiary, they must comply with the following new limitation on recovery rules:
  - No recovery if first overpayment occurred more than 3 years before written notification of the overpayment error to the participant or beneficiary, except in the case of fraud or misrepresentation
  - No recovery of an overpayment made to a participant from the participant's beneficiary
  - No recovery of interest or collection costs or fees on the overpayment

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Limitations on Ability to Recover Overpayments

- If the plan seeks to recoup overpayments of an annuity by reducing the participant's or beneficiary's future benefit payments:
  - (a) the amount recouped each calendar year may not exceed 10% of the total overpayment amount;
  - (b) future benefit payments may not be reduced below 90% of the periodic amount otherwise payable under the plan; and
  - (c) the reduction must stop as soon as the full amount of the overpayment is recovered
- If the recovery is via one or more installment payments, the sum of those payments in any calendar year may not exceed the amount the plan could recover by reducing future benefit payments under items (a) through (c) of the preceding sentence

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Limitations on Ability to Recover Overpayments

- Recoupment of amounts other than annuity payments will be subject to requirements to be developed by the Department of Labor
- A plan's efforts to recover overpayments may not include threats of litigation unless the responsible fiduciary determines the plan is reasonably likely to recover more than the cost of recovery
- The use of a collection agency or similar third party to recover an overpayment is now prohibited unless there is a court judgment or settlement agreement authorizing such recovery and the participant or beneficiary ignores or rejects the plan's recovery efforts

Limitations on Ability to Recover Overpayments

- Participants and beneficiaries from whom an overpayment is sought must be permitted to appeal the recovery pursuant to the plan's claims and appeals procedures
- SECURE 2.0 also clarifies that these limitations don't apply to recovery of overpayments from third parties (e.g., the third-party administrators or recordkeepers)

Limitations on Ability to Recover Overpayments

- These conditions, other than the right to appeal, do not apply to protect a participant or beneficiary who is "culpable"
- A participant or beneficiary is "culpable" if the individual bears responsibility for the overpayment (such as through misrepresentations or omissions that led to the overpayment) or knew the benefit payment or payments were materially in excess of the correct amount
- SECURE 2.0 clarifies that an individual is <u>not</u> "culpable" if:
  - (a) they merely believed the benefit payment or payments were or might be in excess of the correct amount,
  - (b) they raised that question with an authorized plan representative, and
  - (c) they were told the payment or payments were not in excess of the correct amount

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Consideration of Potential Hardship

- In determining whether to pursue a recoupment (or the amount of the recoupment), a plan fiduciary may take into account the hardship that recoupment likely would impose on the participant or beneficiary

Reduction of Future Payments or Recovery

- A plan or plan fiduciary will not fail to qualify for relief merely because, after discovering an overpayment, the plan or plan fiduciary:
  - reduces future benefit payments to the correct amount, or
  - seeks recovery from the person(s) responsible for the overpayment

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Rollovers of Inadvertent Benefit Overpayments

- If a plan fiduciary does not seek recovery of the overpayment, the recipient is permitted to continue to treat the overpayment as eligible for a tax-free rollover (if it otherwise qualified as an eligible rollover distribution)
- If the plan fiduciary does decide to recover the overpayment, the portion of the overpayment shall be permitted to be returned to the plan and treated as an eligible rollover distribution transferred to the plan

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Effective Date

- The amendments made by these provisions of SECURE 2.0 are effective immediately.
- Plans, fiduciaries, employers, and plan sponsors are entitled to rely on:
  - A reasonable good faith interpretation of then existing administrative guidance for inadvertent benefit overpayment recoupments and recoveries that commenced before the date of enactment of this Act; and
  - Determinations made before enactment by the responsible plan fiduciary, in the exercise of its fiduciary discretion, not to seek recoupment or recovery of all or part of an inadvertent benefit overpayment
- In addition, any recovery of overpayments that was in place prior to the enactment of SECURE 2.0 may continue after the effective date

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CODIFICATION OF AUTOMATIC ENROLLMENT CORRECTION

AUTOMATIC ENROLLMENT FAILURES – BACKGROUND

- Under EPCRS, the failure to implement a deferral election or increase in a deferral election results in a "missed deferral opportunity" for which the employer is required to make a qualified nonelective contribution (QNEC) on behalf of the participant in an amount of 50% (sometimes reduced to 25%) of the amount the participant would have deferred into the Plan, plus earnings, subject to applicable limits
- In addition, the participant is entitled to 100% of the missed match they would have received had their deferral been implemented correctly

AUTOMATIC ENROLLMENT FAILURES – BACKGROUND

- In 2015, the IRS issued Revenue Procedure 2015-28, providing a new safe harbor correction method for elective deferral failures in plans with an automatic enrollment failures
  - Rev. Proc. 2015-28 provided that the failure to automatically enroll an employee, the failure to implement an affirmative deferral election in lieu of automatic enrollment, or the failure to apply an automatic increase to a participant's deferrals could be corrected without making a qualified nonelective contribution (i.e., a 0% QNEC), if certain conditions were met

AUTOMATIC ENROLLMENT FAILURES – BACKGROUND

- Conditions:
  - Correct deferrals must start on or before the earlier of 9 ½ months after the end of the Plan year in which the failure first occurred; or the pay period on or after the end of the month following the month during which the affected participant notifies the Plan Sponsor of the deferral failure
  - The plan sponsor must make a matching contribution equal to 100% of what the participant would have deferred, plus earnings
  - The impacted participant must be provided notice of the failure within 45 days of correct deferrals commencing. The notice contains several requirements aimed at assisting the participant in understanding the error, and how they may make affirmative elections to increase their deferrals to make-up for the missed deferral opportunity

AUTOMATIC ENROLLMENT FAILURES – BACKGROUND

- Under Rev. Proc. 2015-28, the safe harbor correction method was only available with respect to failures that began on or before December 31, 2020
- Revenue Procedure 2021-30 (the current version of EPCRS) extended the sunset to December 31, 2023
- SECURE 2.0 makes the safe harbor permanent, retaining the same conditions that must be satisfied for reliance

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EXCISE TAX FOR LATE REQUIRED MINIMUM DISTRIBUTIONS

Consequences of RMD Failures

- When a qualified retirement plan doesn't pay required minimum distributions (RMDs) under Internal Revenue Code (the "Code") Section 401(a)(9) in a timely manner to participants and beneficiaries:
  - The plan sponsor faces the potential disqualification of the plan; and
  - The plan participant who should have received the RMD is liable for an excise tax under Code Section 4974, equal to 50% of the amount of the RMD that was not received

Correction of RMD Failures

- Under EPCRS, plan sponsors can voluntarily correct the failure to make RMDs and may also request a waiver of the participant-owed excise tax in the VCP submission
- In some cases, RMD failures can be self-corrected. However, the participant-owed excise tax cannot be waived when the failure is self-corrected

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SECURE 2.0 Change

- Effective for tax years beginning after December 29, 2022, the excise tax imposed on a participant or beneficiary for a failure to timely take RMD payments is reduced from 50% to 25% of the shortfall

SECURE 2.0 Change

- There is also a further reduction to 10% of the shortfall if:
  - (1) a taxpayer receives a distribution, during the "correction window," of the amount of the missed RMD from the same plan to which the excise tax relates; and
  - (2) the taxpayer submits a return during the correction period reflecting the excise tax
- The last day of the correction window is the earliest of:
  - (1) the date of mailing a notice of deficiency with respect to the excise tax;
  - (2) the date on which the excise tax is assessed; or
  - (3) the last day of the second taxable year that begins after the end of the taxable year in which the excise tax is imposed

EXTENSION OF PLAN AMENDMENT DEADLINE

Plan Amendment Deadline

- Code section 401(b) generally requires discretionary amendments to be adopted prior to the end of the year the amendment is effective
  - Exception: Amendments that reduce benefits
- SECURE 2.0 extends that deadline to the due date of the tax return (including extensions) for the year the amendment is effective if the amendment increases benefits

Plan Amendment Deadline

- Applies to stock bonus, pension, profit sharing and annuity plans
- Excludes amendments to increase matching contributions
- Amendment must otherwise comply with the applicable Code requirements

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