ROBERTS & HOLLAND LLP

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FAVORABLE MODIFICATIONS TO IRS CORRECTION PROGRAM FOR 401(K) DEFERRAL ERRORS

Some of the most common errors in 401(k) plan administration include deferral errors such as the failure to correctly implement employees' contribution elections or election changes and the failure to provide employees with the opportunity to start contributions upon becoming eligible under the plan. Fortunately, the IRS has recently provided less costly options for correcting these common failures and made other favorable modifications to its voluntary correction program.

Existing Procedures for Correcting Deferral Errors

The IRS Employee Plans Compliance Resolution System ("EPCRS") provides approved correction procedures that permit retirement plan sponsors to resolve various types of compliance failures without losing the plan's tax-favored status. Under the most recent EPCRS, which was released in Revenue Procedure 2013-12, in order to correct deferral errors, the plan sponsor must fund a deferral corrective contribution of 50% of the missed deferral amount plus a match corrective contribution equal to the match the employee would have received had there not been a deferral failure plus earnings through the date of correction.

New Options for Correcting Deferral Errors

Some 401(k) plans provide an automatic enrollment feature under which eligible employees are automatically enrolled to make contributions at a default percentage specified in the plan unless they affirmatively elect otherwise. Despite encouragement from the IRS, some employers have been reluctant to incorporate automatic enrollment into their plans because of the increased risk of deferral errors and the high cost associated with the corrective contributions required under the existing procedures. In response to these concerns and to encourage regular review of plan operation and prompt correction of deferral errors, the IRS recently issued new guidance found in Revenue Procedure 2015-28 that modifies the EPCRS to provide more favorable correction options for automatic contribution and other deferral failures, effective April 2, 2015.

The modified procedures eliminate or reduce the deferral corrective contribution currently required under existing EPCRS procedures where failures are identified and corrected within certain time periods. The match corrective contribution and related earnings adjustment still must be made by the plan sponsor in accordance with the existing procedures. In addition, the modified procedures are available only if a notice of the failure is given to affected employees within 45 days of the date on which correct deferrals begin.

Deferral Corrective Contribution Relief for Failures to Implement Automatic Contributions

- No deferral corrective contribution is required under the modified procedures to correct failures to implement an automatic contribution election or an affirmative election made in lieu of an automatic contribution that do not extend beyond the 9-½ month period after the end of the plan year in which the failure occurred. If the participant notifies the plan sponsor of the failure sooner than the 9-½ month period, then the plan sponsor must implement deferrals by the first pay period on or after the last day of the month following the month of notification in order to get this relief.

- A reduced deferral corrective contribution of 25% of the missed deferral amount is required under the modified procedures (instead of the 50% provided for under the existing procedures) for failures that extend beyond this 9-½ month period but are corrected no later than the first payroll period after the second plan year following the plan year when the failure first arose.

Deferral Corrective Contribution Relief for Other Elective Deferral Failures

- No deferral corrective contribution is required under the modified procedures to correct failures to implement a deferral election and failures to provide the opportunity to make a deferral election that do not extend beyond any three-month period if the plan sponsor corrects the deferral failure no later than the first payroll period after the three-month period from when the failure first arose (sooner if the participant notifies the plan sponsor of the failure). This modification significantly expands existing procedures which limit relief from the deferral corrective contribution only to failures that occur in the first three months of the plan year.

- A reduced deferral corrective contribution of 25% of the missed deferral amount is required under the modified procedures (instead of the 50% provided for under the existing procedures) for failures that extend beyond a three-month period but are corrected no later than the first payroll period after the second plan year following the plan year when the failure first arose.

Other Modifications made to Voluntary Correction Program

In separate guidance, the IRS also recently issued modifications to existing EPCRS procedures, which include (i) clarification that plan benefit overpayments paid to participants may not have to be recouped from the participant in certain situations if other corrective actions are taken by the plan sponsor and (ii) an extension of the period of time available to correct excess annual additions for 401(k) plans that also provide for non-elective employer contributions that are not matching contributions. In addition, the modifications reduce the application fees for voluntary correction program submissions for plan loan and required minimum distribution failures.

Conclusion

The new, less costly options for correcting deferral errors apply only if failures are identified and corrected during certain periods ranging from three months to two years. As a result, in order to take advantage of these new options, plan sponsors should institute internal controls that provide for regular review of the plan's administration and operation of enrollment and deferral elections.

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For guidance on complying with the above rules or for more information, please contact Norman J. Misher at (212) 903-8733; Allen J. Erreich at (212) 903-8769; Charles C. Shulman at (212) 903-8687; Judy M. Hensley at (212) 903-8737; or Chase B. Steinlauf at (212) 903-8736.