April 13, 2015

CAB 15-4

Milliman

CLIENT ACTION Bulletin
Employee Benefits

IRS Eases Correction Methods for Common 401(k)/403(b) Plan Failures

SUMMARY

The IRS released guidance that will allow sponsors of 401(k) and 403(b) plans to easily correct two common administrative errors without first having to obtain approval from the agency. *Revenue Procedure 2015-28* modifies and improves the Employee Plans Compliance Resolution System (EPCRS) by providing a new safe harbor relating to automatic contribution features (including automatic enrollment and automatic escalation of elective deferrals) and a separate new special safe harbor correction method for faulty elective deferrals that occur over a period of limited duration.

DISCUSSION

The IRS issued *Revenue Procedure 2015-28* in response to public comments received and provides guidance to simplify the procedures and reduce the cost of the correction process when a 401(k) or 403(b) plan using automatic enrollment or automatic increases fails to implement the correct amount of employee contributions.

Automatic Contribution Features

Revenue Procedure 2015-28 addresses two common failures relating to: starting an automatic contribution feature for an eligible employee and increasing an eligible employee's election under an automatic contribution feature, both of which would require the employer to make up contributions to correct the missed opportunity of the participant. Effective immediately, no qualified nonelective contribution (QNEC) by the plan sponsor for the missed elective deferrals is required, as long as all the following conditions are satisfied:

- The correct deferrals of affected participants' pay must begin no later than the earlier of: a) the first paycheck on or after the last day of the 9-1/2 month period after the end of the plan year in which the failure first occurred, or b) the first paycheck on or after the last day of the month after the month the affected eligible employee notified the plan sponsor;
- Notice of the failure is given to the eligible employee no later than 45 days after the date on which correct deferrals begin; and
- Any missed matching contributions are made within the timing requirements stated in the IRS's Self-Correction Program (SCP) rules for "significant operational failures" and the missed matching contributions are adjusted for "earnings."

There is also a new alternative safe harbor method for calculating earnings for plan failures with an automatic contribution feature. If the eligible employee has not designated a choice from the menu of plan investment options, missed earnings may be calculated based on the plan's default investment alternative (DIA), as long as the matching contribution is not reduced for any net losses the DIA has incurred.

Elective Deferrals

If elective deferrals or automatic contribution/escalation features are not completed as requested by the participant, the plan has incurred a failure. As well, a failure occurs if the employee was improperly excluded from the plan and did not have the opportunity to join the plan when eligible.

Revenue Procedure 2015-28 provides the following safe harbor correction methods for elective deferral failures:

- *Rolling three-month exception* – The guidance creates a rolling correction period for elective deferral failures that do not exceed three months. Under this safe harbor, no QNEC is required to be contributed by the plan sponsor for the missed elective deferrals, provided that two conditions are satisfied. First, correct deferrals must begin no later than the earlier of: a) the first payment of compensation made on or after the last day of the three-month period that begins when the failure first occurred, or b) the first payment of compensation made on or after the last day of the month after the month of notification, if the employee notified the plan sponsor. Second, the plan sponsor must make a corrective contribution, adjusted for earnings, equal to the plan's matching contributions in accordance with timing requirements under SCP for significant operational failures.

- *Failures lasting beyond three months but do not extend beyond the SCP correction period for significant failures* – This safe harbor correction reduces the plan sponsor's corrective contribution to 25% of the missed deferrals (25% QNEC) instead of the current 50% QNEC, provided that two conditions are satisfied. First, correct deferrals must begin no later than the earlier of: a) the first payment of compensation made on or after the last day of the second plan year following the plan year in which the failure occurred, or b) if the plan sponsor was notified of the failure by the eligible employee, the first payment of compensation made on or after the last day of the month after the month of notification. Second, corrective contributions (the 25% QNEC plus employer missed matching contributions) must be made in accordance with the timing requirements under SCP for significant operational failures, adjusted for earnings.

Under both safe harbor correction methods, a notice of the failure must be given to the employee no later than 45 days after the date on which correct deferrals begin. The notice must include:

- general information relating to the failure, (i.e., the percentage of eligible compensation that should have been deferred and the approximate date that the compensation should have begun to be deferred);
- a statement that appropriate deduction amounts have started/will start;
- a statement that all corrective contributions have been/will be made;
- an explanation that the affected participant may increase the deferral percentage in order to make up for the missed deferral opportunity; and
- the name of the plan and plan contact information (name, address, e-mail address, and telephone number of a plan contact).

The guidance provided in *Revenue Procedure 2015-28* is effective Apr. 2, 2015. The new safe harbor for automatic enrollment plans carries a "sunset" date of Dec. 31, 2020. The IRS will consider whether to extend the safe harbor correction method for failures that begin in later years.

ACTION

The new guidance provides welcome relief from the current EPCRS correction methods for automatic contribution features and elective deferral failures. Plan sponsors should review the modifications made by this new guidance and update any procedures, forms, and notices required to ensure compliance.

For additional information about the IRS's *Revenue Procedure 2015-28,* please contact your Milliman consultant.