Have you Improperly Excluded an Employee from your Plan? New IRS Guidance Changes Correction Procedures

By: Alex Mattingly on July 19, 2021 on graydon.law

The IRS has recently released the latest version of its correction program for retirement plans (referred to as **EPCRS or Rev. Proc. 2021-30**) that will make it easier for a plan sponsor to correct certain plan errors. One common error that can arise during the administration of a 401(k) plan is the improper exclusion of an employee from making elective deferrals for a period of time. Employers can rectify these failures by making corrective contributions based on the employee's "missed deferral." The employee's missed deferral is equal to the employee's compensation during the excluded period multiplied by a percentage that is dependent on the type of plan involved (e.g., the applicable percentage for a plan subject to ADP testing is the ADP of the employee's group for the affected plan year). The general correction procedures for an elective deferral failure require the employer to make a contribution equal to 50% of the employee's missed deferral, but certain exceptions to the general rule can reduce the contributions to 25% or 0% of the missed deferral.

The first exception to the general rule is for employers that find and make a correction within 3 months of the initial failure (or no later than the first payment of compensation made on or after the end of the month following the month of notification, if notified of the failure by the employee sooner). This exception remains unchanged by the release of the new version of EPCRS. An employer that makes a correction within this time period can do so without making a corrective contribution for the missed deferral opportunity, but only if the employer corrects the exclusion going forward, provides proper notification to the excluded participants, and contributes any missed matching contributions to the excluded participants' accounts as if the participants made contributions equal to the missed deferral amount.

An exception to the general rule also allows a reduced contribution for employers that find and make a correction after 3 months but within 3 years of the initial failure (or no later than the first payment of compensation made on or after the end of the month following the month of notification, if notified of the failure by the employee sooner). This exception became more generous under the new version of EPCRS, as the maximum time period has been extended from 2 years to 3 years. An employer that makes a correction within this time period can do so by making a reduced corrective contribution to excluded participants of 25% of the missed deferral opportunity, but only if the employer corrects the exclusion going forward, provides proper notification to the excluded participants, and contributes any missed matching contributions to the excluded participants' accounts as if the participants made contributions equal to the missed deferral amount.

Employers with automatic contribution features were permitted to reduce corrective contributions to 0% if the failure did not extend beyond the end of: (1) nine and a half months after the end of the plan year in which the automatic contribution or increase should have occurred, or (2) the last day of the month following the month in which the participant advises the sponsor of the problem. Under the prior version of EPCRS, this provision was only applicable for errors that occurred prior to January 1, 2021. Fortunately for employers, the IRS has extended the sunset on this provision by 3 years, and employers can again use this correction method for any errors that occur prior to January 1, 2024. The employer can make the auto-deferral correction without making a corrective contribution for the missed deferral opportunity, but only if the employer corrects the exclusion going forward, provides proper notification to the excluded participants, and contributes any missed matching contributions to the excluded participants' accounts as if the participants made contributions equal to the missed deferral amount.

The revisions made to the correction procedures for missed deferrals was only a portion of the changes made by the new version of EPCRS. We will revisit EPCRS and discuss the other changes in future blog posts. Should you discover a plan error, any of Graydon's employee benefits attorneys are able to assist.