



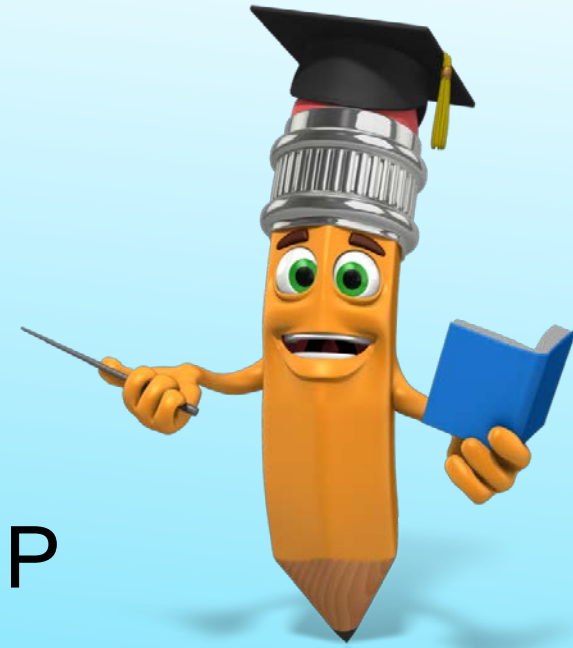
Self-correction in 2023

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Agenda

- ▶ Self-Correction Under SECURE 2.0
- ▶ Eligible Inadvertent Failures
- ▶ Unanswered Questions
- ▶ In Comes Notice 2023-43
- ▶ Corrections Specifically Ineligible for SCP
- ▶ Unanswered Questions on the Notice



Self-Correction Under SECURE 2.0



- ▶ Section 305 of SECURE 2.0 provides:
 - ▶ “Any eligible inadvertent failure ... may be self-corrected under [EPCRS]”
 - ▶ Exceptions:
 - ▶ Failure was identified by IRS before any action that demonstrates a specific commitment to implement the self-correction; or
 - ▶ Self-correction is not completed within a reasonable period after such failure is identified.
- ▶ Directs the IRS to issue a new EPCRS procedure within 2 years

Self-Correction Under SECURE 2.0



- ▶ Section 305 specifically notes that loan failures may be self-corrected
 - ▶ Self-corrected loans avoid deemed distribution treatment
- ▶ The DOL is directed to treat any self-correction under these rules to meet the requirements of VFCP (in other words, corrected loans are not prohibited transactions)
 - ▶ But, the DOL can require reporting or other procedures

Self-Correction Under SECURE 2.0



- ▶ The IRS is instructed to amend EPCRS to allow self-correction of IRA issues by IRA custodians
 - ▶ Including allowing automatic waiver of RMD penalties from IRAs
 - ▶ Not effective until IRS issues new Revenue Procedure



Eligible Inadvertent Failure (EIF)



- ▶ Defined by the law to be:
 - ▶ A failure that occurs
 - ▶ Despite the existence of practices and procedures
 - ▶ That satisfies the standards of Section 4.04 of Rev. Proc. 2021-30 (which requires that the established practices and procedures be “reasonably designed to promote and facilitate overall compliance in form and operation with applicable Code requirements”)

Eligible Inadvertent Failure (EIF)



▶ Does not include:

▶ Egregious failures – EPCRS examples:

- ▶ Plan that consistently and improperly covers only HCEs
- ▶ Plan that provides more favorable benefits to owners based on purported collective bargaining agreement
- ▶ DC plan where contributions for HCE are several times greater than \$415 limit
- ▶ Diversion or misuse of plan assets; or
- ▶ Failures related to an abusive tax avoidance transaction

Initial Things to Note



- ▶ EPCRS limits self-correction to operational failures (i.e., failure to follow the plan's terms) and certain limited document failures
 - ▶ SECURE 2.0 says “any EIF” – including demographic failures, previously unlisted document failures, and employer eligibility failures
- ▶ EPCRS limited self-correction of significant operational failures to a 3-year correction period
 - ▶ SECURE 2.0 says it can be corrected any time before the IRS identifies the failure

Enter Notice 2023-43



- ▶ IRS issued Notice 2023-43 to answer many of these questions while the new EPCRS procedure is being drafted
- ▶ Note: The Notice becomes obsolete when the new procedure is issued
 - ▶ Nothing requires the IRS to take the same positions in the final guidance that it is taking in the Notice



Effective Date for New SCP Rules



- ▶ Notice 2023-43 provides that the new procedures can be used to correct any eligible EIF in a qualified plan, 403(b) plan, SEP, or SIMPLE, even if it occurred before SECURE 2.0 became law
 - ▶ Corrections in process should be reevaluated to see whether anything has changed
 - ▶ Should VCP filings due to timing issues that are still awaiting IRS attention be revoked?
 - ▶ No
 - ▶ May not be able to recoup the user fee ...

Specifically Ineligible for SCP



- ▶ Notice 2023-43 specifically excludes certain failures from self-correction
- ▶ Question: is that list exclusive?
 - ▶ It would seem that, other than the failures discussed above (i.e., egregious, misuse of assets, ATATs) and those on this list, any failure that is an EIF may be self-corrected



Specifically Ineligible for SCP: List



- ▶ Notice 2023-43 specifically excludes:
 - ▶ Failures to initially adopt a written plan or post-2008 403(b) plan
 - ▶ What about participating employers in CG/ASG plans? (later)
 - ▶ Failures in orphan plans
 - ▶ Significant failures in terminated plans
 - ▶ BUT: does not define “terminated plans”
 - ▶ upon action to terminate (what if assets aren’t paid out within a reasonable time)?
 - ▶ upon payout of assets?

Specifically Ineligible for SCP: List



- ▶ Notice 2023-43 specifically excludes (cont.):
 - ▶ Failure involving excess contributions to a SEP or SIMPLE IRA where the correction leaves the excess in participant's IRA
 - ▶ Failures in SEP/SIMPLE that do not use model or prototype plan document
 - ▶ Does that mean they needed to be on model/prototype document when the failure happened or upon correction?
 - ▶ Failures under IRC §409 in ESOPs (and, especially §409(p)) that involve tax consequences other than disqualification

EPCRS Self-Correction Rules That Are Obsolete



- ▶ Requirement that the plan have a favorable determination letter or be on a preapproved document
- ▶ Exclusion of demographic and employer eligibility failures from self-correction
- ▶ Prohibition of self-correction of SEP and SIMPLE significant failures
- ▶ Prohibition or limitation on self-correction of loan failures

EPCRS Self-Correction Rules That Are Obsolete (cont.)



- ▶ Time limit on self-correction of significant failures
 - ▶ Eliminates former 3-year limit on self-correction
 - ▶ Requires correction be completed within a reasonable period after discovery
 - ▶ Requires correction be completed before failure “identified by IRS”, unless sponsor had demonstrated a specific commitment to correct

Questions and Answers on the Notice



What Does “Identified by the IRS” Mean?



- ▶ If the IRS has identified the failure, it is too late to self-correct a significant failure absent a “specific commitment to correct”
- ▶ Notice 2023-43 uses the EPCRS definition of “Under Examination”



“Under Examination”



- ▶ Plan is under an Employee Plans examination; or
- ▶ Plan sponsor is under an Exempt Organization examination; or
- ▶ Plan is under investigation by the Criminal Investigation Division of the IRS; or
- ▶ Plan or Plan Sponsor (or authorized representative) has received verbal or written communication of impending examination or referral for examination; or
- ▶ Plan/Plan Sponsor in appeals or litigation from something that arose under Employee Plans or Exempt Organization examinations

What Does “Identified by the IRS” Mean?



- ▶ Note: the existence of the examination or future examination is sufficient – the IRS does not have to have actually identified a specific failure to have “identified” the failure
- ▶ Insignificant errors can still be self-corrected, even after the plan has been identified by the IRS



What is a “Specific Commitment to Correct?”



- ▶ Facts and Circumstances determination
- ▶ “Actively pursuing correction”
- ▶ Does not include:
 - ▶ Completing a compliance audit
 - ▶ Having a general statement of intent to correct errors if and when discovered
 - ▶ What about hiring a TPA or lawyer to correct a specific failure?
 - ▶ Do you need to have already decided on a correction?

Correction Within a “Reasonable Period”



- ▶ Notice 2023-43 requires that the failure be corrected within a reasonable period after identification
- ▶ “Reasonable period” is facts and circumstances determination
- ▶ Notice provides that time is “deemed reasonable” if correction occurs by last day of 18th month following failure identification
 - ▶ This should be a “safe harbor”



IMPORTANT

Correction Within a “Reasonable Period”



▶ Re: Employer Eligibility Failure

- ▶ What it is: the adoption of a type of plan by an employer that is ineligible to have that kind of plan
 - ▶ E.g., governmental organization with a 401(k) plan
 - ▶ E.g., non-501(c)(3) nonprofit with a 403(b) plan
- ▶ Absolute deadline to cease contributions in an employer eligibility failure is 6 months after identification



Side Note



- ▶ Notice how important keeping track of identification date is
 - ▶ Cannot have made significant commitment to correction of failure until failure identified
 - ▶ 18-month period is judged with reference to the date of identification
 - ▶ IRS requires that record be kept of the date identified



Interaction of Identification and Timely Correction



- ▶ If the IRS provides notice of examination, how do the “identification” rules and the “timely correction” rule interact?
 - ▶ “Timely correction” is a requirement for self-correction, but it is not a factor in determining whether there is a specific commitment to correction so that self-correction is permitted after examination notice is received



Self-Correction Timing vis-à-vis IRS Exam Avoiding CAP



▶ Example #1:

- ▶ Plan sponsor identifies failure on Monday
- ▶ On Tuesday, plan sponsor retains legal counsel to help it correct the failure and begins collecting data to send to legal counsel for that purpose
- ▶ On Wednesday, before any additional corrective activity has begun, the IRS issues an examination notice
- ▶ We think the plan sponsor has made specific commitment to correct; self-correction is still permitted

Self-Correction Timing vis-à-vis IRS Exam

Avoiding CAP



▶ Example #2:

- ▶ Plan sponsor identifies failure on Monday
- ▶ On Tuesday, plan sponsor retains legal counsel to help it correct the failure and begins collecting data to send to legal counsel for that purpose
- ▶ 12 months later, no correction activity has occurred
- ▶ IRS issues exam notice on 12 months and one day
- ▶ Did the failure to act for 12 months negate the specific commitment to correct?



Self-Correction Timing vis-à-vis IRS Exam Avoiding CAP



▶ Example #3

- ▶ The employer from Example 2 is permitted by the IRS to proceed with self-correction
- ▶ However, the employer continues to dawdle on the self-correction, and 2 years pass from date of identification
- ▶ While the employer was eligible to self-correct, the self-correction process was faulty, and the correction failed; plan is at risk for disqualification



Self-Correction Timing vis-à-vis IRS Exam Avoiding CAP



▶ Example #4:

- ▶ Plan sponsor identifies failure on Monday
- ▶ On Tuesday, plan sponsor retains legal counsel to help it correct the failure and begins collecting data to send to legal counsel for that purpose
- ▶ 19 months later, plan sponsor and legal counsel have worked diligently to correct, but factors beyond their control have delayed the correction
- ▶ At 19 months plus one day, the IRS provides notice of examination

Self-Correction Timing vis-à-vis IRS Exam Avoiding CAP



▶ Example #4 (cont.):

- ▶ “Reasonable time” is a facts and circumstances determination and “18-month rule” is just a safe harbor
- ▶ The plan sponsor would need to convince the IRS that the correction period of more than 18 months was still a “reasonable time” for correction under the facts and circumstances



Practices and Procedures



- ▶ The IRS requires that the plan have practices and procedures in place when the failure occurred
- ▶ EPCRS provides that:
 - ▶ The procedures may be formal or informal (but how do you prove the existence of informal procedures?)
 - ▶ Must be “reasonably designed to promote and facilitate overall compliance in form and operation” with the Code

Practices and Procedures



- ▶ What we believe is true, although neither EPCRS nor Notice 2023-43 specifically discuss this, is:
 - ▶ Having a TPA is not “practices and procedures”
 - ▶ As noted above, hard to provide informal procedures, so written is better
 - ▶ In addition, the Notice requires demonstration of existing procedures and procedural changes after self-correction to avoid recurrence
 - ▶ Procedures can include knowing when to get assistance from service providers



Practices and Procedures



▶ Examples:

- ▶ Responsible person at plan sponsor's office has and commonly refers to a calendar of deadlines during the year
- ▶ Payroll department has procedures for properly calculating salary deferrals
- ▶ Client has written procedure for remitting deferrals and loan payments to recordkeeper
- ▶ Client has procedures for requesting or confirming participant loans and distributions

Practices and Procedures



► Examples:

- Plan sponsor has a “phone tree” of which provider to call for which issues
- Plan sponsor has designated the person in its office that is to respond to participant requests for information or benefit payments
- Plan sponsor has designated substitutes to take plan action if the person to whom responsibility is assigned is out of the office or unavailable
- Annual review of plan documents with provider to ensure they are up to date

Is VCP Obsolete?



- ▶ No. BUT, you may still want to file if:
 - ▶ You do not know the proper way to correct
 - ▶ The plan sponsor has no demonstrable practices and procedures, so self-correction eligibility is in question
 - ▶ The error is one of those excluded from self-correction
 - ▶ Plan sponsor (or other concerned party, such as buyer) is nervous
 - ▶ You're concerned that you've exceeded a "reasonable time" to self-correct
 - ▶ Plan sponsor wants to use an unorthodox correction method, such as creating a cutback for the owner

Notes on Correction Methods



- ▶ Must follow general EPCRS §6 principles
- ▶ Can use corrections specified in Appendix A or B
 - ▶ Not required to do so



How Are Demographic Failures Corrected?



- ▶ The notice provides that demographic failures must be corrected using the method under Treas. Reg. §1.401(a)(4)-11(g)
 - ▶ **Retroactive corrective amendment**
 - ▶ Benefits and BRFs not reduced from plan terms in effect immediately before the amendment
 - ▶ Amendment effective as if made on the first day of the plan year being corrected
 - ▶ **Requires increase in benefits or entry of additional participants to meet coverage**

How Are Demographic Failures Corrected?



- ▶ Treas. Reg. §1.401(a)(4)-11(g) (cont.)
 - ▶ **Corrective amendment:**
 - ▶ Must be adopted and implemented within 9½ months of close of plan year for which it applies
 - ▶ n/a for self-correction (if 9½ months rule is met, no need for EPCRS)
 - ▶ Retroactive benefits must be provided to a nondiscriminatory group
 - ▶ If BRF, amendment must eliminate BRF or expand the group of employees to whom the BRF is available

How Are Demographic Failures Corrected?



- ▶ Treas. Reg. §1.401(a)(4)-11(g) (cont.)
 - ▶ **Corrective amendment:**
 - ▶ If correcting a coverage requirement for a 401(k)/401(m) plan:
 - ▶ Must grant QNECs to NHCEs to who eligibility is extended to meet coverage
 - ▶ Amount: NHCE compensation for the plan year x ADP (or ACP) for NHCEs for the year (no reduction of percentage, as is permitted for failure to permit deferral)
 - ▶ Amendment must have substance



How Are Demographic Failures Corrected?



- ▶ **Treas. Reg. §1.401(a)(4)-11(g) (cont.)**
 - ▶ **Note:** 1.401(a)(4)-11(g) does not discuss earnings on additional contributions, but EPCRS requires earnings for self-correction
 - ▶ **Notice 2023-43 says sponsor may not correct**
 - ▶ “using a special testing provision set forth in §1.401(a)(4)-8 [cross-testing] or §1.401(a)(4)-9 [DB/DC Combo or restructuring]”; or
 - ▶ By providing benefits primarily to short-service or low-paid employees

How Are Demographic Failures Corrected?



- ▶ Treas. Reg. §1.401(a)(4)-11(g) (cont.)
 - ▶ Re prohibition on cross-testing, DB/DC combo, or restructuring:
 - ▶ What if the plan always used those techniques in the past, but simply made an error that caused the demographic failure ...
 - ▶ Does that mean that you must correct without these techniques?
 - ▶ If so, can you VCP to retain those techniques?



Can All Document Failures Be Self-Corrected?



- ▶ As noted earlier, cannot self-correct failure to initially adopt plan
 - ▶ Ongoing question: what about related employer's failure to adopt controlled/affiliated service group plan?
 - ▶ Is this a failure to initially adopt or an operational failure of covering people not eligible to participate?
 - ▶ Because plan has been adopted by “employer” (under CG/ASG rules), we believe it is an operational failure that can be self-corrected

Can All Document Failures Be Self-Corrected?



- ▶ Can self-correct failure to amend timely for law changes/restatement cycle
 - ▶ We believe that the rules outlined by IRS in prior guidance continue to apply to late restatements
 - ▶ Must treat plan as individually designed after cycle ends and update for unadopted remedial amendments to be “requalified” for interim period
 - ▶ May then restate back onto preapproved plan and have reliance for future periods

Correction of Operational Failures by Amendment



- ▶ Plan does not operate according to its terms and client wants to amend the plan to match operations
 - ▶ Not a document failure, but the correction of an operational failure by amendment
 - ▶ Historically, such self-corrections were limited by EPCRS
 - ▶ Notice permits self-correction of operational failure by amendment to align plan with actual operations
 - ▶ No benefit may be less favorable to participant than under original provisions
 - ▶ No limitation to BRF issues

Correction of Operational Failures by Amendment



▶ Example #1

- ▶ Plan provides for eligibility of 1 year, age 21
- ▶ For years, the plan sponsor has allowed people to participate immediately upon hire
- ▶ Plan may be amended retroactively to change eligibility to match actual operations
- ▶ Must satisfy coverage before and after amendment

Correction of Operational Failures by Amendment



▶ Example #2

- ▶ DB Plan and PS plan are cross-tested together and pass cross-testing with flying colors
- ▶ Company owner bemoans that he did not amend the DB plan before year end to increase benefits to the highest level that the cross-testing results would permit
 - ▶ Secure permits adoption of amendment to increase benefits by tax return due date, but we are past that – this guy really dawdled
- ▶ Cannot amend plan now, because he did not operate the plan with the increased benefits

Correction of Operational Failures by Amendment



▶ Example #3

- ▶ Company sponsors DB plan for its employees
- ▶ The valuation for the DB was done for years excluding an employee who the TPA thought worked fewer than 1,000 hours (she didn't)
- ▶ The cost of correction (i.e., of providing the benefit that she would have earned) is \$50,000
- ▶ Plan sponsor wants to amend the plan to retroactively exclude her
 - ▶ Plan coverage would be met even if she were excluded

Correction of Operational Failures by Amendment



▶ Example #3

- ▶ Not permitted
- ▶ Even though this matches plan documentation to operations, this is providing a lower benefit to a participant than would be provided under the existing plan terms
- ▶ Violates anti-cutback rule



Self-Correcting Loan Failures



- ▶ Loan failures generally result in taxable income to the participant
- ▶ Historically, could only avoid this result through self-correction in limited situations; otherwise, VCP needed
 - ▶ Could self-correct loan default
 - ▶ Could not self-correct excess loan or loan with due date after 5 years
- ▶ Under Notice 2023-43, can self-correct all loan EIFs
- ▶ How does one self-correct various loan failures?
 - ▶ Follow principles of EPCRS §6.07

Self-Correcting Loan Failures



- ▶ Issue #1: We let people take loans and the plan did not allow
 - ▶ Amend the plan to match operations
 - ▶ Can limit amendment to permitting loans by just the people who actually took them, if they are NHCEs
 - ▶ Be careful of discrimination issues in general with this
 - ▶ If only the owners knew about loan availability, the amendment won't fix the lack of availability to other employees

Self-Correcting Loan Failures



- ▶ Issue #2: The loan exceeded limits
 - ▶ The excess loan is taxable (and can issue Form 1099-R for current year or the year in which the loan was issued)
 - ▶ Can correct by repaying the excess portion of loan now



Self-Correcting Loan Failures



- ▶ Issue #3: The loan was not repaid timely
 - ▶ Can consider the outstanding loan to be income in current year rather than in year of default
 - ▶ Must adjust for accrued interest to date deemed
 - ▶ If we are within 5 years of the loan's initial issuance, can reamortize loan over remaining portion of the 5-year period
 - ▶ Participant can pay all o/s amounts now, and continue payments as due

Self-Correcting Loan Failures



- ▶ Issue #4: There was no loan documentation, but loan was administered in conformance with IRC §72(p) otherwise
 - ▶ Can this be corrected by having documentation signed retroactively to match how the loan was treated?
 - ▶ Can we avoid taxation by having the participant immediately repay the loan in full?
 - ▶ Do we have a PT because we violated plan provisions?
 - ▶ Was this a disguised distribution?

Recordkeeping Requirements



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Notice 2023-43 Requires Certain Records



▶ Plan must document:

- ▶ The failure, including years of occurrence, and the number of affected employees
- ▶ Date when failure was identified by plan sponsor
- ▶ Explanation of how the failure occurred
- ▶ Demonstration of existence at the time of the failure of practices and procedures that were reasonably designed to promote and facilitate overall compliance

Notice 2023-43 Requires Certain Records

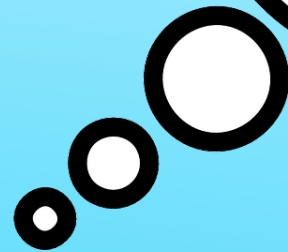


- ▶ Plan must document (cont.):
 - ▶ Identification and substantiation of correction method
 - ▶ Must include date of correction
 - ▶ Changes made to practices and procedures to avoid recurrence





Closing Thoughts



Thank you!



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