

# EPCRS—The Eraser for Employee Benefit Plans

*By Susan M. Szafranski*

Susan M. Szafranski explains the IRS's Employee Plan Compliance Resolution System and the requirements involved in making voluntary and timely corrections of operational errors and plan document errors under employer sponsored qualified retirement plans.

**M**istakes happen—when you write with a pencil, there is comfort in knowing that mistakes can be erased and corrected. The Internal Revenue Service's (IRS) Employee Plan Compliance Resolution System (EPCRS), Revenue Procedure 2006-27, 2006-22 I.R.B. 945, gives similar comfort to plan sponsors. Under EPCRS, plan sponsors can “erase” and correct any operational errors and plan document errors that occur under qualified employee pension benefit plans, Code Sec. 403(b) plans, Simplified Employee Pension Plans (SEPs) and Simple Individual Retirement Account plans (Simple IRAs). EPCRS is designed to encourage plan sponsors to make voluntary and timely corrections of operational and plan document errors. EPCRS is the eraser for employee benefit plan mistakes.

This article discusses the basics of EPCRS, the common operational errors that can be corrected under the self-correction program (SCP) of EPCRS, the advantages and disadvantages of correcting operational and plan document errors under SCP and the Voluntary Correction Program with IRS approval (VCP), the operational errors that may occur in connection with employees returning from a military service leave of absence and a wish list for the next version of EPCRS. Although EPCRS covers Code Sec.

403(b) plans, SEPs and Simple IRAs, the article will focus on qualified employee pension plans.

## ABCs of EPCRS

Plan sponsors can correct certain operational errors under SCP. Under SCP, there is no IRS involvement and the plan sponsor is not required to pay a fee. On the other hand, under VCP, plan sponsors can correct operational and plan document errors by filing a submission with the IRS and paying a fee based on the number of participants in the plan.

In connection with developing and implementing methods to correct operational errors under SCP, or to correct operational and plan document errors under VCP, the plan sponsor should keep in mind the basic principles of EPCRS. These basic principles are the foundation for reasonable and appropriate correction methods.

The pivotal basic principle of EPCRS is that the correction method should be one that puts the plan and the plan participants in the position that they would have been in had the error not occurred. In other words, the correction method must make the plan and the plan participants whole. Also, the correction method should be reasonable and appropriate for the error. Generally, a correction method will be deemed reasonable and appropriate for a particular error if that correction method is described in EPCRS with respect to such error. For example, if the plan sponsor uses the one-to-one correction method (described

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below) to correct a failure to satisfy the actual deferral percentage test (ADP Test), because the one-to-one correction method is one of the correction methods described in EPCRS to correct a failure to satisfy the ADP test, the correction method would be considered by the IRS to be reasonable and appropriate.

EPCRS describes the following situations where full correction is not required:

- Although it is possible to make exact calculations of the corrective contributions or allocations, reasonable estimates may be used when there is an insignificant difference between the amount produced by using actual data and the amount produced by using reasonable estimates, and the administrative cost of making exact calculations significantly exceeds the probable difference.
- If there is not sufficient data to make exact calculations, reasonable estimates may be used. For example, investment return information for the plan from eight years ago (which is part of the correction period) was stored in a warehouse that was destroyed by a fire. For purposes of calculating earnings, a reasonable interest rate may be used if it is not possible to make reasonable estimates of investment performance over the correction period.
- A corrective distribution of \$50 or less due to a terminated participant who has taken a distribution of his or her entire account balance is not required to be distributed to the participant, provided that the cost of processing the distribution exceeds the amount of the corrective distribution.
- If an overpayment made, or an excess amount paid, to a participant is not more than \$100, the plan sponsor may, but is not required, to request that the participant repay the overpayment amount to the plan. Also, the plan sponsor is not required to notify the participant that the overpayment amount was not eligible to be rolled over to an Individual Retirement Account (IRA) or another employer's plan. This exception to full correction is not free. In order to take advantage of this exception, the plan sponsor must make the corrections under VCP and pay the VCP fee—this exception does not apply to corrections made under SCP.

An overpayment is the amount distributed to a participant that exceeds the participant's benefit under the terms of the plan. An excess amount is an overpayment, the amount of employee contributions distributed to satisfy Code Sec. 415,

the amount of employee deferrals distributed in excess of the limit under Code Sec. 402(g), the amount distributed to satisfy Code Secs. 401(k) or 401(m), the amount of employee deferrals distributed to satisfy the Code Sec. 401(a)(17), or any other amount distributed to maintain the plan's tax qualified status.

- If participants cannot be located after sending correspondence to their last known address and using a locator firm, the correction will nonetheless be considered complete. If a participant later reappears, the plan sponsor is required to pay the participant the corrective benefit.

Full correction under EPCRS is required. This means that operational and plan document errors that occurred in closed tax years must be corrected. However, the tax liability associated with a closed year does not have to be redetermined and reported to the IRS. Sometimes it may not be possible to completely erase mistakes. The IRS recognizes that full correction of operational and plan document errors may not be feasible. With this in mind, the IRS set forth exceptions to the full correction rule where full correction is unreasonable. There is no exception to full correction merely because it is inconvenient or administratively burdensome (but not unreasonable) for the plan sponsor to effectuate a full correction. For example, the plan fails to properly vest participants during the last fifteen plan years and the records relating the service dates of the affected participants are located in boxes stored at an outside location. It may be inconvenient for individuals to look through the boxes to confirm service dates, but it is feasible and likely would not be considered by the IRS as unreasonable.

The correction method should be a method that gives additional benefits to nonhighly compensated employees rather than simply taking away benefits from highly compensated employees. Keep in mind that it is better to give than take back. The correction should keep assets in the plan unless other guidance from the IRS allows correction by distribution to participants or the return of assets to the plan sponsor. Generally, corrective distributions should only be made if the participants were not entitled to the erroneous amounts in their accounts.

The correction method used by the plan sponsor to correct operational and plan document errors cannot be a method that causes other errors to occur. For example, a plan erroneously permitted a loan repayment period of 10 years for nonresidential home loans. The plan document provided that the

maximum repayment period for nonresidential home loans is five years. The plan cannot be amended to provide for a maximum loan repayment period of 10 years for nonresidential loans because such an amendment would violate Code Sec. 72(p) of the Code (the maximum repayment period for nonresidential home loans is five years).

Corrective contributions and distributions must be adjusted for earnings based on the earnings adjustment procedures set forth in EPCRS. For corrections made under a defined benefit plan, earnings should be based on the interest rate under the plan used to calculate benefits. For example, if an interest rate of eight percent is used to calculate benefits under the plan, eight percent should be used to calculate earnings. For defined contribution plans, the actual investment performance of the affected participant's account or the plan as a whole should be used to calculate earnings.

If an overpayment amount or an excess amount has been distributed to the participant, the plan sponsor must notify the participant that such amount was not eligible to be rolled over (except in those cases where full correction is not required because distribution was less than \$100) and correction was made under VCP. Because the participant was not entitled to the overpayment amount or an excess amount, it is not eligible to be rolled over to an IRA or another employer's plan. Upon being notified that a certain amount was not eligible to be rolled over, the participant should request the IRA custodian or the plan administrator of the other employer's plan to distribute that amount to him or her. This step in the correction will undoubtedly cause affected participants heartburn particularly if the rollover occurred some time ago. Once the notification is given to the participant, and any revised Forms 1099-R are issued, the correction is completed as to the plan. The plan does not have any responsibility for following up with the participant to confirm that the participant effectuated the distribution from the IRA or the other employer's plan.

The corrective amounts are taken into account in the annual addition determination for the year in which the corrective amounts relate, and not the year in which the corrective amounts are contributed to

the plan. For example, the plan sponsor discovers that it failed to make an employer contribution to the plan for 2006. Based on the allocation formula under the plan, Employee A is entitled to \$5,000, Employee B is entitled to \$6,000 and Employee C is entitled to \$4,000. The amounts actually contributed to the plan during that plan year are as follows: Employee A—\$25,000, Employee B—\$35,000 and Employee C—\$43,000. The annual addition limit under Code Sec. 415(c) for 2006 was \$44,000.

The total annual additions after taking into account

**Table 1.**

Employee	Previous Amount	Corrective Amount	Total
A	\$25,000	\$5,000	\$30,000
B	\$35,000	\$6,000	\$41,000
C	\$43,000	\$4,000	\$47,000

the corrective amounts for Employee A and Employee B do not exceed the limit for 2006. However, the total annual additions after taking into account the corrective amount for Employee C does exceed the limit. Therefore, \$1,000 of the \$4,000 allocated to Employee C will be forfeited in order to satisfy Code Sec. 415(c).

Generally, plan assets cannot be used to fund

the corrective contributions. However, the forfeiture account can be used to fund corrective contributions, provided that the plan provides that forfeitures may be used to reduce employer contributions.

Finally, the plan sponsor is required to change its administrative procedure to ensure that error does not reoccur. The plan sponsor may have to dedicate additional resources for plan administration or require changes to its third-party administrator's procedures, in order to prevent future errors.

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## Common Errors Corrected in SCP

Under EPCRS, the IRS allows plan sponsors to correct certain operational errors under SCP. Plan document errors cannot be corrected under SCP—they must be corrected under VCP. An operational error is a

qualification error that arises solely from the failure to follow the plan's terms. The failure to properly vest participants under a plan is an operational failure. A plan document error is a provision (or the absence of a provision) that, on its face violates the requirements of Code Sec. 401(a). The failure to timely adopt a good faith amendment for the changes in the law made under the Economic Growth and Tax Reconciliation Relief Act of 2000 (EGTRRA) is a plan document error.

In order for a plan sponsor to be eligible to correct an operational error under SCP, certain requirements must be satisfied. The first requirement is that there are practices and procedures in place reasonably designed to promote overall plan compliance. The practices and procedures do not have to be formalized, but they have to be established and routinely followed by the individuals who are responsible for the administration of the plan. The IRS has opined that a plan document alone is not evidence of established practices and procedures. An example of an established procedure is a process flow that describes the procedures to be followed when a participant requests a hardship withdrawal.

The second requirement is that significant operational errors must be corrected by the last day of the second plan year following the plan year in which the error first occurs. For example, if a significant operational error first occurs in 2006, the plan sponsor can correct this error under SCP, provided that the error is corrected by Dec. 31, 2008. To be eligible to correct a significant operational error under SCP, the plan must have a current favorable determination letter. If the plan does not have a current favorable determination letter, significant operational errors will have to be corrected under VCP. Thus, it is important for plan sponsors to timely submit their plans to the IRS for a determination letter during the designated staggered remedial amendment periods.

If the operational error is insignificant, the plan sponsor may correct the error under SCP at any time, including after the end of the second year following the plan year in which the error first occurs. If there is more than one operational error that has occurred under the plan, the errors, in the aggregate, must be insignificant for the plan sponsor to correct under SCP after the end of the two-year period. To determine whether operational errors are insignificant, the factors that should be considered, include, but are not limited to (no single factor is determinative) the following:

- number of participants affected by the error relative to the number of participants that could have been affected by the error;
- number of plan years during which the error occurred;
- amount of plan assets and contributions involved in the error;
- whether the error corrected as soon as possible after discovery of the error; and
- the reason for the failure (for example, errors in the transcription of data, the transposition of numbers, or minor arithmetic errors).

Although the IRS does not give a bright-line benchmark for determining what constitutes a significant failure, the IRS has informally indicated that if no more than 10 percent of the participants or assets are involved in the error, the error is likely insignificant.

If the operational error is egregious, the error cannot be corrected under SCP. Examples of egregious errors include improperly covering highly compensated employees on a consistent basis, contributions to highly compensated employees that considerably exceed the limit under Code Sec. 415 of the Code, and repeated failures to follow the plan's terms. Plan sponsors must examine all of the facts and circumstances giving rise to the errors and determine whether the operational errors are significant or insignificant, and whether the operational errors are egregious.

The following examples illustrate the determination of insignificant and significant errors:

**Example 1.** A Code Sec. 401(k) plan provides that participants are fully vested upon completion of three years of service. The 401(k) plan fails to fully vest participants upon completion of three years of service. Of the 1,000 participants in the plan, 20 participants were not properly vested. Of the \$2M in plan assets, \$150,000 of plan assets were involved in the error. The error first occurred in 2004 and the plan sponsor effectuated correction as soon as the error was discovered. Because this error was not corrected by Dec. 31, 2007 (the last day of the second plan year following the plan year in which the error first occurred), the error must be insignificant to be corrected under SCP. The error affects two percent of the participants in the plan, 7.5 percent of the plan assets are involved in the error and the error occurred during four plan years. Based on these factors the error is insignificant and can be corrected under SCP.

**Example 2.** A defined-benefit plan fails to offer participants the opportunity to elect two of the six optional forms of benefit available under the plan. Of the 2,000 participants in the plan, 450 participants are affected by error. Of the \$10M in plan assets, \$1.5M of plan assets is involved in the error. The error occurred during the 2002 through 2008 plan years. Approximately 22.25 percent of the participants in the plan are involved in the error (450/2,000) and 15 percent of the plan's assets are involved in the error (\$500,000/\$10M). This error cannot be corrected under SCP. The error is significant because more than 10 percent of the participants and 10 percent of the plan's assets are involved in the operational error, and the error was not corrected by Dec. 1, 2004.

While corrections made under SCP do not require the IRS's approval, the IRS may review SCP correction methodologies during a subsequent audit of the plan. For this reason, the plan sponsor should keep accurate records of the correction methods used, including calculations of corrective contributions and corrective distributions. After the correction has been completed, it is prudent to write a self-correction memo and retain it in the plan's files. In case of an audit by the IRS years after the correction has been completed, the current individuals responsible for the plan will be able to demonstrate to the IRS that the correction was completed and in what manner. A self-correction memo should include the following information: description of the operational error, date that the plan sponsor discovered the operational error, plan years in which the operational error occurred, the participants involved in the operational error, the amount of plan assets involved in the operational error, the basis for correcting the operational error under SCP, the determination that the operational error was significant or insignificant (if the operational error was significant attach a copy of the favorable determination letter), the correction method used, copies of the relevant sections of the plan document, calculations of corrective contributions and corrective distributions, calculation of earnings, including supporting documentation for the rate of return or the interest rate

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used to determine earnings, copy of checks or wire transfers to the plan's trust evidencing deposit of the corrective contributions, copies of checks evidencing the corrective distributions, copies of letters to the affected participants, if the operational error involves a failure to obtain spousal consent, copies of spousal consent forms, if the operational error involves a failure to offer participants all of the optional forms of benefit available under the plan, copies of the revised election forms and the participants' responses, if the operational error involves a failure to satisfy the ADP and/or ACP tests, copies of the original test and the revised test (as modified by the corrections), and if letters are returned for any affected participants, proof that a letter forwarding program was used.

Generally, an operational error is corrected under SCP by putting the plan and plan participants in the position that they would have been in had the operational error not occurred. Only in limited situations may correction of an operational error under SCP be effectuated by a retroactive plan amendment (otherwise correction by retroactive amendment has to be effectuated under VCP). EPCRS permits plan sponsors to adopt retroactive plan amendments under SCP to correct the

following operational errors: inclusion of otherwise ineligible employees, allowing hardship withdrawals without such a plan provision, and allowing loans without such a plan provision. This permissive retroactive amendment for loans only applies in situations where the plan document did not include a loan provision. The plan cannot be retroactively amended under VCP to allow a loan repayment period of more than five years for loans for the purchase of a primary residence.

The operational errors that can be corrected under SCP by a retroactive plan amendment are nominal. As discussed below, the IRS should consider expanding the list of operational errors that can be corrected under SCP by retroactive plan amendment.

Table 2 illustrates common errors that can be corrected under SCP and illustrates common correction methods (note: there are other appropriate correction methods for each of the operational errors).

As described in the above corrections, the corrective amounts with respect to the correction for

**Table 2.**

ERROR	CORRECTION
Failure to satisfy the ADP Test and/or the ACP Test in a prior plan year.	Correct the error using the “one-to-one correction” method. Determine the amount of the excess contribution and assign an amount to each highly compensated employee. Calculate the earnings for the excess amounts. Distribute or forfeit (as the case may be) the excess amounts, adjusted for earnings, to the affected highly compensated employees. The sum of the excess amounts, as adjusted for earnings, is contributed to the plan and allocated to eligible nonhighly compensated employees.
Improperly calculated matching contributions for certain participants.	Recalculate the matching contributions for the affected participants. Calculate the earnings on the missed matching contributions. Contribute the corrective amount to the plan on the behalf of the affected participants. Determine if any of the participant’s annual additions for the year in which the matching contributions relate exceed the limit under Section 415 of the Code. Rerun the ACP testing taking into account the corrective matching contributions.
Erroneous exclusion of otherwise eligible employees from making pre-tax contributions in a 401(k) plan.	Calculate the amount of the corrective contribution by multiplying the participant’s compensation by the ADP for the participant’s group (highly compensated employee group or nonhighly compensated employee group). That sum is then multiplied by 50 percent. That result is adjusted for earnings through the date of correction. If the affected employees would have received matching contributions related to the missed pre-tax contributions, a corrective contribution also must be made for the missed matching contributions. The corrective matching contributions are based on 100 percent of the missed pre-tax contributions, adjusted for earnings through the date of correction.
Participants contributed over the Section 402(g) limit for the year.	Distribute the excess deferrals to the affected participants. Issue Forms 1099-R reflecting the amount of the excess deferrals as taxable income in the year of deferral and in the year distributed.
Incorrect definition of compensation.	Recalculate the benefits or contributions using the correct definition of compensation. If the amount of the benefits or contributions are greater than the original benefits or contributions, the plan sponsor will contribute the difference to the plan on behalf of the affected participants. If the amount of the benefits or contributions are less than the original benefits or contributions, the plan sponsor will adjust the affected participants’ benefits or accounts. If any of the affected participants have taken distributions of their entire benefits or account balances, the plan sponsor should treat the difference as an overpayment.
Failed to withhold the amount of deferrals elected by certain participants in a prior plan year.	Contribute the amount of the missed deferrals and related matching contributions, adjusted for earnings.
Failed to timely enroll employees in the plan pursuant to the automatic enrollment procedures.	Enroll the erroneously excluded employees in the plan. The plan sponsor will make corrective contributions to the plan equal to the amounts that the participants would have contributed had they been timely enrolled in the plan, adjusted for earnings. The plan sponsor will also make corrective contributions equal to the amount of any related matching contributions, adjusted for earnings.
Participants were not properly vested. Participants received distributions of their entire account balances and, therefore, received less than they should have received.	Properly vest participants. Restore the erroneous forfeitures to the affected participants’ accounts, adjusted for earnings. Make corrective distributions to the affected participants.
Participants were not properly vested. Participants have account balances under the plan.	Properly vest participants. Restore the erroneous forfeitures to the affected participants’ accounts, adjusted for earnings.
Failed to timely distribute required minimum distributions to certain participants in a defined contribution plan.	Make the missed required distributions (no earnings adjustment).
Failed to timely distribute required minimum distributions to certain participants in a defined benefit plan.	Make the missed required distributions, adjusted for earnings.
Failure to offer all of the optional forms of benefit available under a plan that does not require the benefit to be paid as a qualified joint and survivor annuity to a married participant.	Offer the participants the opportunity to elect one of the optional forms of benefit that was not previously offered. If participants wish to elect one of the optional forms of benefit not previously offered, they must repay to the plan the amount of the original distribution.

ERROR	CORRECTION
Failure to offer all of the optional forms of benefit available under the plan that does require spousal consent to the participants' elections of an optional form of benefit.	Offer the participants the opportunity to elect one of the optional forms of benefit that was not previously offered. If the participants wish to elect one of the optional forms of benefit not previously offered, they must repay to the plan the amount of the original distribution and obtain spousal consent (from the spouse to whom they were married to at the time of the original distribution) to the election of the optional form of benefit.
Failure to obtain spousal consent to a distribution (qualified joint and survivor annuity).	Obtain consent from the spouse to whom the participant was married to at the time of distribution. If the spouse does not provide spousal consent, the plan sponsor has two options. The first option is to make a lump sum payment equal to the present value of the survivor benefit under the normal form of benefit. The second option is to pay the survivor benefit to the spouse upon the death of the participant.
Failure to allow employees to make after-tax contributions to a 401(k) plan.	Calculate the amount of the corrective contribution by multiplying the participant's compensation by the ACP for his or her group (highly compensated employee group or nonhighly compensated employee group). That sum is then multiplied by 40 percent. That result is adjusted for earnings through the date of correction. If the ACP consists of after-tax contributions and matching contributions, the ACP related only to the after-tax contributions can be used in the calculation of the corrective contribution. If the affected employees would have received matching contributions related to the missed after-tax contributions, a corrective contribution also must be made for the missed matching contributions. The corrective matching contribution is based on 100 percent of the missed after-tax contribution, adjusted for earnings through the date of correction.
Failure to cease a participant's deferrals for six months after the participant received a hardship withdrawal.	Determine the amount of the erroneous contributions, as adjusted for earnings through the date of correction. Distribute those corrective amounts to the affected participants and issue the participants Forms 1099-R reflecting the corrective amounts as taxable income. Forfeit any related matching contributions, as adjusted for earnings through the date of correction.
Prior to March 28, 2005, the plan failed to cash out participants whose account balances were not more than \$5,000. Effective March 28, 2005, the plan reduced the cash out threshold to \$1,000 to comply with the automatic rollover rules.	Although the cash-out threshold is now \$1,000, the participants' account balances should have been distributed at the time that the cash-out threshold was \$5,000. The participants' account balances should be distributed now. The correction will put the plan and the participants in the position that they would have been in had the error not occurred.
Defined benefit plan overstated participants' annuity payments based on incorrect data (compensation and/or years of service).	Recalculate the participants' benefits using correct data. Adjust future annuity payments accordingly. The overpayment amounts are the amounts that the participants received less the amounts that they should have received had their benefits been properly determined. Recoup a reasonable percentage of the overpayment amounts from future annuity payments. If a participant dies before the total amount of the repayment can be recouped, the overpayment amount cannot be recouped from the survivor payments made to the participant's beneficiary.
Defined benefit plan understated participants' annuity payments based on incorrect data (compensation and/or years of service).	Recalculate the participants' benefits using correct data. Adjust future annuity payments accordingly. Make a lump sum payment to the participant equal to the amount that the participant should have received had their benefits been calculated properly less the amount they actually received, adjusted for interest through date of correction.
A defined benefit plan failed to issue suspension of benefit notices to certain participants under a defined benefit plan.	The affected participants' accrued benefits should be redetermined. The adjusted accrued benefit is equal to the greater of the accrued benefit determined under the plan's formula or the participants' normal retirement age benefit actuarially adjusted until the date of commencement of payment. A lump sum payment should be made to affected participants who have commenced payment of their benefits equal to the difference between the adjusted benefits and the actual benefits, adjusted for earnings through the date of correction.
Defined benefit plan failed to timely commence annuity payments as a result of an administrative error.	Determine the amount of the annuity payments as of the date that payments should have commenced. Make a lump sum payment to the participant equal to amount of missed annuity payments, adjusted for earnings through the date of correction.

erroneously excluding employees from making pre-tax contributions and after-tax contributions is 50 percent of the ADP and 40 percent of the ACP, respectively. The IRS opined that the corrective amounts are less than 100 percent because the affected employees had use of the amounts that were not withheld from their compensation and contributed to the plan.

If the operational error cannot be corrected under SCP, it may be corrected under VCP.

## **Advantages and Disadvantages of SCP and VCP**

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There are advantages and disadvantages of SCP and VCP. The plan sponsor should carefully consider the facts and circumstances giving rise to the error and the potential correction method in deciding whether to correct under SCP and VCP.

The primary advantage of SCP is that there is no fee for correcting operational errors. Under VCP, there is a fee based on the number of participants in the plan as reflected on the last Form 5500. The fees range from \$750 to \$25,000. Generally, an advantage of SCP over VCP is that there is no IRS involvement in the correction process. The plan sponsor identifies the error and implements the correction without having to obtain prior or subsequent approval of the IRS. Only in the case of a subsequent audit would the IRS review the correction methods used by the plan sponsor to correct an operational error.

But, nothing is perfect. As noted above, plan document errors, and significant errors that are not corrected by the last day of the second plan year in which the error first occurred cannot be corrected under SCP. VCP may be the plan sponsor's only option to correct errors.

Although the absence of IRS involvement is generally considered an advantage of SCP, it may be considered a disadvantage of SCP, and an advantage of VCP, depending on the facts and circumstances surrounding the error and the correction. If the correction method is not a standard correction prescribed under EPCRS or previously approved by the IRS, there is a risk, that upon a subsequent audit, the IRS may not agree with the correction methodology. If this happens, the IRS and the plan sponsor will have to negotiate a correction, and the plan sponsor will likely have to pay a penalty. On the other hand, under VCP, the IRS issues a compliance statement after approval of the correction methods proposed by the plan sponsor in the VCP submission. This may permit the plan to be more creative in crafting the correction

method. The compliance statement is binding upon the IRS and the plan sponsor. The VCP fee may be money well spent to have the blessing of the IRS.

## **Operational Errors in Connection with Employees Returning from Military Leave**

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The final regulations under the Uniformed Services Employment and Reemployment Act (USERRA) require that upon a timely return from a qualified military service leave, returning employees are credited with service equal to their period of military leave for purposes of eligibility, vesting and benefit service under both defined contribution plans and defined benefit plans. USERRA also requires that sponsors of 401(k) plans give the returning employees the opportunity to contribute to the 401(k) plan the amount of deferrals that they could have made during their period of qualified military service leave. If the 401(k) plan provides for matching contributions, the plan sponsor is required to contribute to the plan on behalf of the returning employee those matching contributions related to the make-up deferrals that the returning employee actually makes to the 401(k) plan. If the returning employee does not elect to contribute any make-up deferrals to the 401(k) plan, the plan sponsor is not required to make matching contributions to the plan on such returning employee's behalf. The employee has the lesser of three times his or her period of military service or five years to contribute the make-up deferrals to the 401(k) plan. For profit sharing plans, USERRA requires that plan sponsors contribute to the plan the amount of contributions that returning employees would have received during their military service leave of absence. The make-up contribution does not have to be adjusted for earnings.

Is it an operational error if the plan sponsor does not give employees who are returning from military leave an opportunity to contribute to a 401(k) plan the amount that he or she could have contributed but for the military service leave of absence (in accordance with USERRA)? Similarly, is it an operational error if the plan sponsor does not contribute to the plan the amount of profit sharing contributions the returning employees would have received during their military period of leave? Also, is it an operational error if the plan sponsor does not credit returning employees with service credit for purposes of vesting and benefit accrual under a defined benefit plan?

EPCRS does not address operational errors related to returning employees' USERRA rights with respect to defined contribution plans and defined benefit plans. Nevertheless, operational errors occur if the USERRA rights of returning employees are infringed upon. In connection with the GUST plan restatements, plans were required to be amended to provide that contributions, benefits and service will be credited in accordance with USERRA. Therefore, by not providing the returning employees with the opportunity to elect make-up contributions, not allocating profit sharing contributions, or not crediting service for the period of military leave, the plan's operation will be treated as inconsistent with its terms.

To correct a failure to timely offer the returning employees an opportunity to elect to make make-up contributions, the plan sponsor can extend the period that the returning employees otherwise would have had to make the contributions. Keep in mind that the contribution period for a returning employee to contribute make-up contributions under USERRA is a floor and not a ceiling. The plan sponsor may allow the returning employees more than the lesser of three times the period of military service or five years to make the contributions. Thus, the operational error is corrected by extending the maximum contribution period.

To correct a failure to credit the returning employees with service for their periods of military leave for purpose of vesting, the plan sponsor should credit such service and adjust the vesting for the affected returning employees. If an affected returning employee under a defined contribution plan has received a distribution of his or her account balance, a corrective distribution should be made in an amount equal to the amount that the returning employee should have received had service been properly credited less the amount actually received, adjusted for earnings through the date of correction.

If any affected returning employees under a defined benefit plan have terminated employment and would have been entitled to a benefit if their period of military service was properly credited, they should be notified that they are eligible for a benefit under the plan.

## Wish List for the New EPCRS

EPCRS has provided much needed relief for plan sponsors. Now that the existing correction program is well established and tested, it is time for the IRS to give plan sponsors more flexibility to correct additional errors by retroactive plan amendment and providing additional guidance in connection with implementing corrections.

Rumor has it that the IRS will be issuing a new version of EPCRS soon. On the top of the wish list for EPCRS changes is a bright-line test for determining whether an operational error is significant or insignificant. Such a test will bring reassurance to plan sponsors that their determination that operational errors are insignificant will not be challenged by the IRS during a subsequent audit.

The following are common plan document and operational errors that the IRS should allow plan sponsors to self-correct by a retroactive plan amendment: failure to timely amend the plan to increase the 401(k) deferral percentage, failure to timely amend the plan to increase the matching contribution percentage or amount, failure to timely amend the plan to increase the amount or percentage of a nondiscretionary profit sharing contribution, failure to timely amend the plan to add distribution options, failure to timely amend the plan to change the benefit formula under a defined benefit plan if the formula results in greater benefits for participants, and failure to preserve a Code Sec. 411(d)(6) protected benefit in a restated plan that was included in the older version.

Simply put, if the amendment would not harm nonhighly compensated employees and would not benefit only highly compensated employees, plan sponsors should be allowed to correct an error by retroactive plan amendment under SCP. By expanding the ability to correct by retroactive amendment under SCP, the IRS would be promoting plan compliance. The broader the relief under SCP, the more likely the IRS is to achieve its goal of bringing plans into compliance.

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