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EPCRS update has new overpayment options, expands self-correction

By Brian J. Kearney and Margaret Berger
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In this article

[Overpayments from DB plans](#) | [Overpayments from DC plans](#) | [Self-correction program](#) | [Other changes](#) | [Related resources](#)

The latest version of IRS's Employee Plans Compliance Resolution System ([EPCRS](#)) in [Rev. Proc. 2021-30](#) significantly changes the rules for correcting overpayments from defined benefit (DB) plans. The new rules give DB plan fiduciaries new options for correcting overpayments, while minimizing the participant's repayment burden. Although fiduciaries may welcome the new options, additional guidance is needed to clarify certain aspects of these changes. The new EPCRS has other notable changes, including a longer period to correct errors under the Self-Correction Program ([SCP](#)), elimination of anonymous submissions under the Voluntary Correction Program ([VCP](#)) and a three-year extension of the safe harbor correction method for certain elective deferral errors under auto-enrollment plans.

Overpayments from DB plans

The new EPCRS includes two new correction methods for overpayments from DB plans, giving plan fiduciaries objective criteria for avoiding the unpleasant task of asking participants to pay money back to the plan. The updated procedure also lets plans offer participants a choice of repayment methods, but the applicability of some new provisions may cause confusion.

New correction methods

IRS has added two new EPCRS methods for correcting certain overpayments from DB plans: the funding exception correction method and the contribution credit correction method. These methods minimize — and may even prohibit — the plan from seeking to recover an overpayment from the participant, the sponsor or any other party. Both new methods take the plan's funding level into account in some manner. This addresses long-standing concerns within the pension community about the requirement to repay a well-funded plan or a plan whose minimum required contribution (and therefore, the plan's assets) already reflected the overstated benefits.

New methods unavailable for certain failures. The new methods are only available for certain overpayments, such as those arising from incorrect benefit calculations or failures to reduce a beneficiary's benefit on the participant's death. The new methods aren't available for overpayments due to violations of the Internal Revenue

Code's benefit limits (e.g., the Section 401(a)(17) limit on compensation or the 415(b) limit on annual distributions) or the Section 436 funding-based benefit restrictions. The methods also can't be used to correct overpayments to "disqualified persons" under the Code's prohibited transaction rules or to owner-employees. Plan sponsors may continue to use the return of overpayment or adjustment of future payments methods to correct these failures. Plans using these new methods must comply with EPCRS's general principles for corrections (e.g., using consistent methods to correct similar failures).

Funding exception correction method

A DB plan no longer has to seek recovery of an overpayment if the plan's certified or presumed adjusted funding target attainment percentage (AFTAP) on the date of the correction is at least 100%. The plan must reduce the participant's future benefit payments to the correct amount. However, additional benefit reductions or other recoupment attempts are prohibited, and reimbursement for the overpayment by the sponsor or another party is not required. This method is available only to single-employer plans covered by the Section 436 rules on funding-based benefit restrictions or multiemployer plans that are not in critical, critical and declining, or endangered status.

Contribution credit correction method

Under this method, the total required repayment owed to the plan is reduced by two amounts:

- The cumulative increase in the plan's minimum funding requirements attributable to the overpayments — whether funded in cash or by using the plan's credit balance — during the plan years when the overpayment was reflected in the funding valuation
- Additional contributions in excess of minimum funding requirements after the first overpayment was made, but excluding contributions made for other purposes — for example, contributions to avoid Section 436 benefit restrictions or to correct other plan errors. (Contributions added to the prefunding balance are also excluded from this calculation unless the sponsor makes an election by the date of the correction to reduce the prefunding balance.)

This reduction is called the sponsor's "contribution credit." The participant's future benefit payments must be reduced to the correct amount. If the contribution credit reduces the overpayment to zero, no further reductions to benefit payments or other recoupment efforts are allowed, and no corrective payments from any other party are required. If a portion of the overpayment is still outstanding after applying the contribution credit, the plan sponsor or another party must restore the remaining amount — either by seeking recoupment from the recipient of the overpayment or reimbursing the plan for the unrecovered amount.

Plan must not have unpaid minimum required contributions. The contribution credit correction method is not available if the plan has any unpaid minimum required contributions as of the end of the last plan year before the plan year for which the sponsor reflects the corrected benefit payment amount for minimum funding purposes (taking into account receivable contributions made in the following plan year).

Participant protections. If the sponsor pursues recoupment, Appendix B contains new protections for the overpayment recipient:

- **Participant notice.** The plan must provide a notice to the participant that includes the following information:
 - A description of the error

- The amount of the overpayment
- If the participant is receiving an annuity, the amount of the reduction to the participant's benefit to reflect the correct amount and an estimate of the additional reduction to repay the overpayment
- Estimated repayment amounts if the participant chooses to repay in a single sum or in installments
- An explanation that if the participant doesn't choose a repayment option within a reasonable time (the plan must allow at least 30 days for a response), the default method will be a reduction in future payments if the participant is receiving an annuity or a single-sum payment if the participant is not entitled to future payments from the plan

This notice can be combined with the participant notice that the overpayment is not an eligible rollover distribution (which IRS already required under previous versions of EPCRS).

- **Conditions on repayments.** Plans seeking recoupment must meet the following conditions:
 - The participant must be given a choice of correction methods (a single sum, an installment agreement or a reduction in future benefits).
 - The reduction to future benefits cannot exceed 10% of the corrected benefit payment amount.
 - An installment repayment period must be at least five years.
 - Interest on the net overpayment must begin to accrue on the date corrected periodic payments begin and may not begin to accrue before that date.

Participant choice

Under the updated revenue procedure, plans pursuing recoupment under the contribution credit correction method must offer the overpayment recipient a choice to repay with a single payment, installments or a reduction in future benefit payments. Plans pursuing recoupment under a different correction method can — but aren't required to — offer the same choice. Though not previously prohibited, these options were not explicitly permitted in previous versions of EPCRS.

Overpayments not fully recovered through benefit reductions

If the plan pursues repayment through a reduction in a participant's future benefit payments but recoups less than the entire overpayment (e.g., because the participant dies before repaying the full amount), the sponsor isn't required to make a contribution to the plan for the unrecovered portion.

Clarifications needed

Additional guidance from IRS is needed to clarify certain aspects of these new overpayment rules.

Are the new correction methods optional? The new EPCRS appears to give plans the option to use the funding exception and contribution credit correction methods, rather than requiring plans to use those methods when the conditions for doing so are satisfied. But this flexibility leads to some confusing results. For example, if a plan's AFTAP is over 100%, the funding exception correction method would prohibit recoupment, but the fiduciary could

choose a different correction method that allows recoupment — rendering the prohibition meaningless. Fiduciaries could benefit from guidance on whether any limitations apply to their ability to choose alternative methods.

Do participant protections under the contribution credit correction method apply to all recoupment efforts?

The special recoupment rules for the contribution credit correction method (e.g., notice to overpayment recipients and a choice of repayment options) appear to apply only when plan fiduciaries use this method. But fiduciaries may seek repayment from participants under a different method, so it's unclear why these new protections for overpayment recipients would apply only if fiduciaries choose the contribution credit correction method. In the absence of additional IRS guidance, plan fiduciaries might consider following these rules in all recoupment cases.

Overpayments from DC plans

The changes to the rules for correcting overpayments from DC plans are minor in comparison to the changes for DB plans. A new provision on overpayments involving periodic payments says the plan must reduce future payments to the correct amount as soon as practicable. In addition, like the rules for DB plans, the updated rules for DC plans clarify that plans can give participants a choice of repayment methods, including installments. The remaining updates to the rules for DC plans are largely nonsubstantive organizational changes.

The updated revenue procedure doesn't suggest that any of the new participant protections under the contribution credit correction method (e.g., participant notice, minimum five-year installment period, etc.) apply to overpayment corrections under DC plans. Why IRS would make this distinction is unclear (and it may have been unintentional), so fiduciaries might consider applying those protections anyway.

Self-correction program

Rev. Proc. 2021-30 includes several changes making it easier for employers to correct errors under SCP.

Correction period for significant failures

The revenue procedure extends the self-correction period for significant operational and plan document failures. The self-correction period for these failures now is the last day of the third plan year after the plan year in which the failure occurred — one year longer than previously allowed. Whether a failure is significant depends on the facts and circumstances. Rev. Proc. 2021-30 includes a list of factors to consider when determining if a failure is significant. (This nonexhaustive list is unchanged from the last version of EPCRS.)

Extension of safe harbor correction period for missed deferrals lasting longer than three months. The longer SCP correction period automatically extends the period for correcting elective deferral failures that last more than three months but not beyond the SCP correction period for significant failures. A safe harbor under EPCRS allows plan sponsors to correct these failures by making a qualified nonelective contribution (QNEC) equal to 25% of the participant's missed deferral amount (instead of a 50% QNEC). The reduced QNEC is available only if:

- Correct deferrals begin no later than the first paycheck after the end of the SCP correction period, or if earlier, the first paycheck after the participant notifies the sponsor about the failure.
- The plan notifies the participant about the failure no later than 45 days after correct deferrals begin.
- The sponsor makes the corrective QNEC and any missed matching contributions, including adjustments for earnings, by the end of the SCP correction period.

Additional year for late correction of ADP and ACP failures. The extended SCP correction period also gives employers an extra year to correct failures of the actual deferral percentage (ADP) and actual contribution percentage (ACP) nondiscrimination tests. To avoid disqualification of the plan's cash or deferred arrangement (CODA), an employer must correct ADP and ACP failures by the end of the plan year after the year of the testing failure. If the employer fails to timely correct, the employer can still avoid disqualification by completing a late correction under either SCP or VCP. In this case, the SCP correction period does not start to run until the first day of the second plan year after the testing failure. Under Rev. Proc. 2021-30, the extended SCP correction period means the deadline for a late correction of an ADP or ACP failure to avoid disqualification is now the end of the fourth plan year after the year of the testing failure.

Sunset extended on safe harbor correction auto-enrollment failures

EPCRS provides a safe harbor correction method for certain elective deferral failures under auto-enrollment 401(k) and 403(b) plans. For failures to implement an auto-enrollment feature or a participant's affirmative election of a deferral level other than the default amount under an auto-enrollment plan, the sponsor does not have to make a QNEC for the participant's missed deferral if:

- Correct deferrals begin no later than the first paycheck due 9-1/2 months after the end of the plan year in which the failure occurred, or if earlier, the first paycheck after the participant notifies the sponsor about the failure.
- The plan notifies the participant about the failure no later than 45 days after correct deferrals begin.
- The sponsor makes a contribution for the participant's missed matching contributions and earnings by the end of the SCP correction period.

Under the last version of EPCRS, this safe harbor method had a sunset date of Dec. 31, 2020. Rev. Proc. 2021-30 extends the availability of the safe harbor until Dec. 31, 2023. This change is retroactively effective to Jan. 1, 2021.

Correction by plan amendment

Rev. Proc. 2021-30 eliminates the requirement that a plan amendment adding a benefit, right or feature to correct an operational failure must apply that enhancement to all eligible employees under the plan.

Other changes

Rev. Proc. 2021-30 includes the following additional changes to EPCRS:

- The *de minimis* amount for overpayments and excess contributions and allocations not requiring correction has increased from \$100 to \$250.
- Effective Jan. 1, 2022, IRS will no longer accept anonymous VCP submissions. Instead, eligible plan sponsors intending to file a VCP application for a correction not covered by a safe harbor may request anonymous presubmission conferences with no fee. IRS will grant conferences at its discretion and as time permits.
- Sanctions under the [Audit Closing Agreement Program](#) must be paid through the [pay.gov](https://www.pay.gov) website starting Jan. 1, 2022.

Related resources

Non-Mercer resources

- [EPCRS overview](#) (IRS, July 20, 2021)
- [Rev. Proc. 2021-30](#) (IRS, July 16, 2021)
- [Correcting plan errors](#) (IRS, July 16, 2021)

Mercer Law & Policy resource

- [IRS expands self-correction program for correcting retirement plan errors](#) (May 1, 2019)

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