

IRS Correction Relief for Elective Deferral Errors

On April 2, 2015 the IRS released Revenue Procedure 2015-28 which provides revised correction procedures for correcting a variety of errors with respect to the implementation of a participant's deferral election. The Revenue Procedure discusses corrections for plans with and without automatic enrollment provisions. The cost of the correction depends on whether or not the plan offers automatic enrollment, and how soon after the error occurs that the error is discovered and corrected.

One of the main features of a 401(k) plan is the ability for the participants to elect to defer a portion of their compensation into the plan. In a 401(k) plan with automatic enrollment, the employer automatically enrolls eligible employees into the plan upon their plan entry date if the new participant does not provide an election of their own or does not otherwise opt out of participation. Failure to implement these deferral elections by the employer results in an operational failure that must be corrected.

Previously the IRS released a correction method that called for the employer to make a corrective Qualified Nonelective Contribution ("QNEC") to the plan that represented 50% of the total deferrals that would have been deposited to the plan had the deferrals started on time, plus any missed match, all adjusted for earnings. Since the release of that guidance the IRS has asked for comment on the correction method, as well as suggestions for corrections specific to automatic enrollment plans.

Revenue Procedure 2015-28 ("Rev. Proc. 2015-28") provides the latest IRS guidance on correction methods for missed elective deferrals. Rev. Proc. 2015-28 updates previously issued Revenue Procedure 2013-12, which is the latest complete restatement of the IRS' Employee Plans Compliance Resolution System (EPCRS). Rev. Proc. 2015-28 describes correction methods for both automatic enrollment plans and non-automatic enrollment plans.

Correcting Elective Deferral Errors in an Automatic Enrollment plan

If the plan allows for automatic enrollment, and the employer fails to automatically enroll an eligible employee, or fails to begin the elective deferrals for a participant who provides a deferral election in an automatic enrollment plan, the employer no longer needs to make a corrective QNEC for the employee, providing the employer satisfies three requirements.

First, the employer must implement the default election within a certain time frame, the deadline for which depends on whether the employer is informed by the participant, or the employer discovers the error in some other manner. If the employee informs the employer of the error, then the deferrals must begin no later than the last day of the month following the month in which the error is communicated to the employer. If the employer discovers the error through some other means than being notified by the employee, the deferrals must start no later than 9 ½ months following the end of the plan year in which the error occurred.

Second, the employer must provide the employee with a notice that describes the error and the correction, within 45 days of the start of the deferrals.

And third, the employer must make up any missed match, plus earnings, that the participant would have received if the deferrals had been started timely.

However, please note that the IRS has limited the correction method described above to errors that occur before January 1, 2021. The IRS may extend the application of the correction method after that date but intends to use the intervening time to evaluate the process.

Elective Deferral Errors In Plans Without Automatic Enrollment

Rev. Proc. 2015-28 provides correction relief for employers who fail to start a participant's deferral election, even if the plan does not provide for automatic enrollment.

Under the new procedures, the 50% QNEC contribution can be eliminated or reduced depending on how quickly the error is discovered and corrected.

If the error is discovered within 3 months of the date the deferrals should have begun, then no QNEC is required if the deferrals are started timely. If the employee informs the employer of the error than the deferrals must start no later than the last day of the month following the month in which the employer learns of the error. If the employer finds the error by some other means, then the deferrals must start no later than the end of the 3 month period beginning with the date the deferrals should have started. The employer must provide the employee with a notice that describes the error and the correction, within 45 days of the start of the deferrals, and must contribute any missed match plus earnings.

If the error is discovered after 3 months, but no later than the last day of the second plan year following the plan year in which the error occurred, the 50% QNEC contribution is reduced to 25% if the deferrals are started timely. If the employee informs the employer of the error than the deferrals must start no later than the last day of the month following the month in which the employer learns of the error. If the employer finds the error by some other means, then the deferrals must start no later than last day of the second plan year following the plan year in which the deferrals should have started. The employer must provide the employee with a notice that describes the error and the correction within, 45 days of the start of the deferrals, and must contribute any missed match plus earnings on the QNEC and match.

Clearly one intention of Rev. Proc. 2015-28 is to encourage plan sponsors to self audit their plans on a regular basis so as to be in a position to take advantage of the reduced cost of corrections for errors that are found and corrected early.

Please do not hesitate to contact our office if you have any questions or would like to discuss these new procedures.