When Can I Self-Correct an Error in a Qualified Retirement Plan?

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When an error is made that can affect the qualified status of a retirement plan, it’s important to know when the plan sponsor can take advantage of the IRS’ self-correction program and when the error requires a filing with IRS.

People make mistakes. Even administrators of ERISA plans.

—Supreme Court Chief Justice John Roberts

Errors that can impact the qualified status of a retirement plan happen fairly regularly. The appropriate method of correcting the error can depend on a number of factors—the type of plan, the specifics of the error, when the error occurred. But one question that almost always comes up refers to whether the error is eligible for self-correction or whether the problem will require a filing with the Internal Revenue Service (IRS).

In early 2013, IRS expanded its Employee Plans Compliance Resolution System (EPCRS) to address some new issues and make certain changes. But the need to analyze whether self-correction is a possibility for a given error continues. This article addresses the requirements and other considerations when a plan sponsor must determine whether a mistake requires an IRS filing or not.

Operational Errors Only

The EPCRS refers to its procedure for self-correcting a qualification error as the Self-Correction Program (SCP). If an error is not eligible for the SCP, it may require a filing with IRS under the Voluntary Correction Program (VCP) portion of the EPCRS. As a first step in evaluating whether an error is eligible for the SCP, the plan sponsor must determine the type of error. The EPCRS permits qualified plans to correct only “operational errors” through the SCP. IRS does not permit self-correction for any other type of error.

The EPCRS defines an operational error as an error that arises solely from the failure to follow plan provisions. As a result, plan document errors, such as failing to adopt required plan amendments on a timely basis, cannot be self-corrected and will require a VCP filing with IRS. The EPCRS does permit a plan sponsor to self-correct a limited number of errors through a retroactive amendment in order to
conform the terms of the plan to the plan’s prior operations. Specifically, a plan may use a retroactive amendment to self-correct (1) an annual compensation limit failure, (2) hardship and participant loan failures and (3) early inclusion of otherwise eligible employees. In any other case, a correction requiring a retroactive plan amendment will mandate a VCP filing. In addition, a plan cannot select the SCP option for any “egregious” error or if the plan sponsor has engaged in an abusive tax-avoidance transaction. Plan sponsors may attempt to correct egregious matters or abusive transactions through an IRS filing under VCP. Finally, neither the SCP nor VCP are available to correct failures relating to the diversion or misuse of plan assets.

Practices and Procedures

To use the SCP, the plan must have established practices and procedures reasonably designed to promote and facilitate overall compliance with the qualification requirements. While the EPCRS makes clear that the plan document itself cannot meet this requirement, it does give some flexibility. Specifically, the established procedure could be either “formal or informal.” A good example might be the plan’s recordkeeping operating manual, or a check sheet routinely followed to ensure compliance with various applicable requirements. IRS has taken the position that a plan does not need practices and procedures in place for the specific failure being addressed, as long as general practices and procedures exist demonstrating an overall effort on the part of the plan sponsor to maintain the plan in compliance with the Internal Revenue Code’s qualification requirements.

A plan cannot meet the “established practices and procedures” requirement for self-correction after the fact. In other words, the procedures must have been in place at the time of the error. As a result, plan sponsors should consider reaching out to their recordkeeper or other service providers to inquire what types of policies, manuals or checklists they use in working with the plan that could serve as a basis for meeting this requirement well in advance of discovering any errors. While IRS has demonstrated some leeway in what it may accept, a best practice would include assuring in advance that written policies are in place for meeting the qualification requirements applicable to retirement plans.

Significant vs. Insignificant Failures

For purposes of determining SCP eligibility, IRS draws a distinction between significant operational failures and insignificant operational failures. If an error goes back no more than two plan years, the EPCRS allows for self-correction regardless of whether it is significant or insignificant. If an error goes back longer than that, a plan sponsor can self-correct only if the problem is insignificant. For example, if a plan sponsor discovers an error in 2014, and that error occurred only in 2012, 2013 or 2014, the plan could self-correct the matter even if the EPCRS considers it significant. But if the error also occurred in 2011 or earlier, the plan sponsor must determine that the failure is insignificant before using the SCP.

For the plan sponsor, evaluating which category an error falls into is not an exact science. The analysis relies upon all the facts and circumstances of the case. The EPCRS gives a list of factors to consider when determining whether a failure is significant but makes clear that the list is not exclusive, and the plan sponsor may consider additional relevant factors. No single factor alone is determinative. The explicit factors listed in the EPCRS include:

- Whether other failures occurred during the same period as the error in question
- The percentage of plan assets and contributions involved in the failure
• The number of years the failure occurred
• The number of participants affected relative to the total number of participants in the plan
• The number of participants affected as a result of the failure relative to the number of participants who could have been affected by the failure
• Whether correction was made within a reasonable time after discovery of the failure
• The reason for the failure (e.g., errors in the transcription of data, the transposition of numbers or minor arithmetic errors).

If a plan experiences multiple problems, the insignificant standard is met under the EPCRS only if the matters are insignificant in the aggregate. As a result, the more errors a plan finds, the less likely IRS is to consider them insignificant. To the extent a plan sponsor concludes that an error or group of errors meets the insignificant standard, best practices suggest a complete documentation of the specific reasons and factors relied upon in reaching that conclusion. The plan sponsor should take all steps necessary to enable the re-creation of the analysis in the event that an auditor later challenges the conclusion. If IRS were to audit the plan and disagree with the decision that the error is insignificant, self-correction may not have been appropriate, requiring a full review of the failure and the correction method selected by the plan sponsor.

Under Examination

If an error is discovered while the plan is subject to an IRS examination, the EPCRS limits the plan sponsor’s ability to self-correct the error. Specifically, the plan sponsor can use the SCP while the plan is under examination only if the failure is insignificant, as determined under the standards in the prior section. If the failure is significant, the EPCRS makes self-correction available only if the plan sponsor has substantially completed the correction before notice by IRS of the examination.11

Appropriate Corrections

The plan sponsor needs to give some very careful thought to the best and most fair way to correct a failure when using the SCP. If the plan were to successfully complete a VCP application, it will ultimately have written confirmation that the method of rectifying the problem is acceptable to IRS. Without that written IRS assurance, the plan sponsor should reach a sincere comfort level with the correction method selected.

The EPCRS offers some general guidelines for selecting the appropriate correction method when a plan sponsor self-corrects an error.12 Perhaps the most fundamental principle is that the correction method should restore the plan and the impacted participants or beneficiaries to the position they would have been in had the failure never occurred. In furtherance of this guiding rule, the EPCRS requires that the plan sponsor select a correction method that is “reasonable and appropriate” for the failure in question. When determining if the correction method meets the reasonable and appropriate standard, IRS gives some helpful standards:

• The correction method should, to the extent possible, resemble one already provided for in the EPCRS, the Code or other official guidance.
• The correction method should keep plan assets in the trust.
• The correction method for failures relating to nondiscrimination testing should provide additional benefits for non-highly compensated employees.

**takeaways >>**

- Plan document errors cannot be self-corrected and will require a Voluntary Correction Program filing with IRS.
- To use the Self-Correction Program, the plan must have established practices and procedures reasonably designed to promote and facilitate overall compliance with the qualification requirements.
- Written policies should be in place for meeting retirement plan qualification requirements.
- The Employee Plans Compliance Resolution System allows for self-correction, regardless of whether an error is significant or insignificant, if an error goes back no more than two plan years.
- The more errors a plan finds, the less likely it is that IRS will consider them insignificant.
- An important guideline for selecting the appropriate correction method is that the correction method should restore the plan and the impacted participants or beneficiaries to the position they would have been in had the failure never occurred.
- A well-defined set of steps to make certain the plan stays on the correct path demonstrates a strong intention of good faith.
• The correction method should not violate another applicable specific qualification requirement.

IRS has been fairly generous in offering specific guidance relating to acceptable methods of correcting some of the most common retirement plan mistakes. The EPCRS contains several appendices discussing some of the more ordinary errors and the preapproved courses of action that a plan may take upon finding those errors, as well as methods for calculating earnings on additional contributions that may be part of the correction process. The appendices include plenty of examples that plan sponsors may find helpful in crafting the best repair. Additionally, the IRS website offers a handy fix-it guide that lists numerous real-life examples of problems found while administering qualified plans and the solutions specifically approved by IRS.

IRS has made clear that the methods of correction for specified errors as listed in the EPCRS itself will be deemed “reasonable and appropriate.” But IRS has not taken the position that these are the only reasonable and appropriate methods for correcting the error. As a result, plan sponsors have a certain level of flexibility. If IRS has specified a reasonable correction for a mistake, the plan sponsor is not strictly bound to use that correction method. The sponsor could fashion a different correction as long as it meets the reasonable and appropriate standard for the failure in question. If a plan sponsor finds a problem that approximates an error and correction method articulated by IRS in the EPCRS or elsewhere, the safe approach may be to use that specific fix to the extent possible. If the plan sponsor selects a different fix for whatever reason, it should be certain it would be comfortable defending the correction to an external auditor in the event it is ever questioned. Whatever correction method is selected, it needs to be applied consistently to all participants who are impacted by the failure. Especially when correcting a mistake through the SCP, plan sponsors should craft the appropriate solution with serious consideration and forethought.

**Additional Items to Consider**

Many plan sponsors choose the self-correction option when an operational failure is eligible for the SCP. As one of the primary advantages for using the SCP, IRS will impose no filing fee or other type of sanction on the plan sponsor. Additionally, the plan sponsor can often complete the self-correction process much more quickly than when the plan engages in a full VCP filing. But self-correcting also has some disadvantages.

Principally, self-correction generally involves a certain level of uncertainty. Because there’s no filing involved, the plan sponsor does not receive a compliance statement from IRS, which leaves the correction open to potential challenges from the annual external audit necessary for most plans’ Form 5500 filing or from a future IRS audit. The auditor could conclude that the error was significant and thus ineligible for the SCP under the circumstances, or that the correction method was not appropriate. Without an IRS compliance statement addressing the error, the plan sponsor has no guarantee that the failure won’t create future issues for the plan.

Consequently, when choosing to self-correct an eligible error, the plan sponsor should engage in some best practices. The key here is to document precisely what steps were taken and why. If the error goes back more than two plan years, why did the plan sponsor conclude that the problem was insignificant, and therefore eligible for the SCP? What precise steps were taken in correcting the failure? Be certain to include a clear description of what steps were taken to assure that the error would not recur in the future. A well-defined set of steps to make certain the plan stays on the correct path going forward demonstrates a strong intention of good faith that typically does not go unnoticed by auditors.

**Closing**

While using the SCP to correct qualification errors in a retirement plan can have certain disadvantages, IRS has expressly sanctioned the approach. And many plan sponsors elect the SCP approach when an error is eligible as a way of streamlining the correction process as well as ongoing plan administration. By carefully selecting an appropriate correction method and documenting the steps and analyses taken, the SCP can be an advantageous tool for plan sponsors in relation to all sorts of retirement plan pitfalls.

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**Endnotes**

2. IRS Revenue Procedure 2013-12. The EPCRS is specific to correcting errors in qualified retirement plans. IRS offers separate guidance for correcting errors in a nonqualified retirement plan. IRS Notice 2010-6, IRS Notice 2008-113. However, options and opportunities for correcting errors in nonqualified plans are much more limited than the tools for correcting a qualified retirement plan error under the EPCRS. Further, the EPCRS solely addresses the correction of qualification errors under the Internal Revenue
Code. Correcting a problem under the EPCRS only addresses the qualification of the retirement plan. If a mistake also raises issues under the Employee Retirement Income Security Act or other portions of the Internal Revenue Code, the plan sponsor may need to take steps in addition to correcting under the EPCRS. For example, if a qualification failure also results in a prohibited transaction or a fiduciary breach, additional action may be needed beyond the correction under the EPCRS.

3. EPCRS §4.01(1).
4. EPCRS §5.01(2)(b).
5. If a plan sponsor self-corrects one of these errors through retroactive amendment, the sponsor must file the plan for a determination letter with IRS during the plan’s next on-cycle plan year. The determination letter filing must expressly disclose the plan’s use of self-correction via a retroactive amendment. As a result, using a retroactive amendment to self-correct in these circumstances necessarily will trigger IRS scrutiny, unlike other types of corrections under the SCP.

6. EPCRS §4.11. “Egregious” errors include (1) a plan that has consistently and improperly covered only highly compensated employees; (2) a plan that provides more favorable benefits for an owner of the employer based on a purported collective bargaining agreement where there has in fact been no good faith bargaining; and (3) a defined contribution plan where a contribution is made on behalf of a highly compensated employee that is several times greater than the dollar limit set forth in Internal Revenue Code §415(c).
8. EPCRS §4.12.
10. This example presumes the plan has a calendar plan year.
11. EPCRS §4.02.
12. EPCRS §6.02.
13. EPCRS Appendixes A, B and C.
14. See www.irs.gov/Retirement-Plans/401(k)-Plan-Fix-It-Guide. The heading of the web page suggests that the focus is solely on 401(k) plans. However, the site contains some descriptions of errors and corrections that are not unique to 401(k) plans. For example, the web page addresses use of an incorrect definition of compensation and problems with participant loans and hardship distributions, which are errors that occur in non-401(k) retirement plans. Consequently, the web page can serve as a resource for sponsors of different types of retirement plans.

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