Secure 2.0 Corrections - EPCRS/Overpayments

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The information provided during this program does not constitute legal advice. In addition, this program only provides a summary of certain complex and always evolving laws and regulations. Attendees should consult their legal counsel for guidance on the application and implementation of the many federal and state laws that impact employee benefit plans and the workplace, including the topics discussed during this program.

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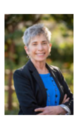
Today's Presenters

Sherrie Boutwell

Sherrie has focused for thirty years in the areas of employee benefits law and ERISA, with an emphasis on retirement and deferred compensation plans. She advises and counsels a broad range of clients, including employers, employees, plan fiduciaries, financial institutions, government agencies and trade associations, on a wide range of employee benefits matters. Sherrie has extensive experience and is a highly sought-after speaker, writer, and advisor on employee benefits topics



Deborah Fabricant

Deborah Fabricant has spent substantially all of her legal career in the area of employee benefits law and ERISA. Ms. Fabricant's prior ERISA litigation experience, expertise and perspective make her uniquely suited in her current practice to provide pre-litigation fiduciary advice and counsel to ERISA plan sponsors and plan fiduciaries and to represent clients before the United States Department of Labor, the Internal Revenue Service and the Pension Benefit Guaranty Corporation.

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Background - EPCRS

The rules before Secure 2.0

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What is EPCRS?

EPCRS is a comprehensive system of correction programs for certain retirement plans that have not met the requirements for tax favored status. It permits Plan Sponsors to correct certain failures restore the Plan's tax-favored basis. See Rev. Proc. 2021-30. EPCRS consists of 3 "programs":

1. the Self-Correction Program ("SCP");
2. the Voluntary Correction Program ("VCP")(IRS filing and fee required); and
3. the Audit Closing Agreement Program ("Audit CAP")(closing agreement and penalty required).

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Why did Congress Act?

401(k) plans (and other tax favored plans) are complicated pieces of machinery, with many moving parts and many ways to break down. The risk of making a mistake, even an inadvertent mistake, is high. The potential costs of that mistake (plan disqualification) are even higher.

To help mitigate these risks, the Internal Revenue Service has offered some form of voluntary correction program since at least 1996 and has continually updated and improved the program. However, EPCRS (Revenue Procedure 2021-30) often required a filing with the IRS to implement a correction and long waiting periods (1+ years being not unusual) to get a compliance statement.

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Secure 2.0 - EPCRS

The new rules after Secure 2.0

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What Changed under Secure 2.0?

Under Secure 2.0, the opportunities to self-correct "inadvertent" errors in both qualified plans (and now also IRA based plans) under EPCRS has now been dramatically expanded. Section 305(a) of the Secure Act generally provides as follows:

- *Except as otherwise provided in* the Internal Revenue Code of 1986, **regulations, *or other guidance of general applicability prescribed by the Secretary of the Treasury*** (emphasis added),
- Any ***eligible inadvertent failure*** to comply with the rules applicable under section 401(a), 403(a), 403(b), 408(p), or 408(k) of such Code may be self-corrected under Revenue Procedure 2021–30, or any successor ''EPCRS'' guidance)(emphasis added).

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Which errors may be self-corrected under Secure 2.0?

Under Secure 2.0, five requirements now apply to SCP:

1. The error cannot be a type of failure that the IRS defined as not eligible (will need regulatory or soft guidance on this);
2. The error cannot be a type of failure that Congress defined as not eligible;
3. The error must be inadvertent, i.e., the plan must have had and routinely followed administrative practices and procedure to prevent the error;
4. The plan cannot be under examination (unless certain requirements are met); and
5. The method of correction must conform with the general principles that apply to corrections of such failures under the Internal Revenue Code of 1986, including regulations or other guidance issued thereunder and including those principles and corrections set forth in Revenue Procedure 2021–30 (or any successor guidance).

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What is an "Eligible Inadvertent Failure"?

- Under Secure Act 2.0, the term "eligible inadvertent failure" means a failure that occurs despite the existence of practices and procedures which— (A) satisfy the standards set forth in section 4.04 of Revenue Procedure 2021–30 (or any successor guidance), or (B) satisfy similar standards in the case of an individual retirement plan.
- Section 4.04 of Revenue Procedure 2021-30 requires that the plan have established practices and procedures (formal or informal) reasonably designed to promote and facilitate overall compliance in form and operation with applicable Code requirements and these established procedures must have been in place and routinely followed.

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What is not an "Eligible Failure"?

- Secure 2.0 has an exception for any failure which is
  - Egregious failures (VCP or audit CAP are available, but with higher costs);
  - Relates to the diversion or misuse of plan assets (no formal EPCRS program is available); or
  - Is directly or indirectly related to an abusive tax avoidance transaction (other EPCRS programs may be available).

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What is an "Egregious" Failure?

- Under Rev. Proc. 2021-30, situations where a failure is considered "egregious" generally include any case in which the IRS concludes that the parties controlling the plan recognized that the action taken would constitute a failure and the failure either involves a substantial number of participants or beneficiaries or involves participants who are predominantly highly compensated employees.
- If a failure is egregious, SCP is not available and the VCP fee may be a higher than the normal filing fee.

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What is "Egregious"?

- Examples of "egregious failures" include (but are not limited to):
  - (a) a plan that has consistently and improperly covered only highly compensated employees;
  - (b) 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 between bona fide employee representatives and the employer (see Notice 2003-24, 2003-1 C.B. 853, with respect to good faith bargaining and welfare benefit funds); or
  - (c) 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 § 415(c).

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What is an "Egregious" Document Failure?

- A nonamender failure may be considered to be egregious based on all of the facts and circumstances, including, but not limited to:
  - (i) the number of plan amendments that were not timely adopted;
  - (ii) the number of years that had elapsed from the end of the remedial amendment period until amendments were adopted (if at all); and
  - (iii) the extent to which the plan lacked internal controls to facilitate the timely adoption of amendments.

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Is there a deadline to self-correct?

Under Revenue Procedure 2021-30, specific time periods applied to "significant" failures. Secure 2.0 changes that. It provides that except as otherwise provided under such Code, regulations, or other guidance of general applicability prescribed by the Secretary, the time period for self-correction is indefinite and has no last day.

So, if a specific time period is specified in the Code or regulations, the self-correction period is not indefinite. For example, there is a specific correction in the for exceeding the Code §402(g) amounts. See, Treas. Reg. §1.402(g)-1(e)(2).

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Is there a deadline to self-correct (cont.)?

Section 305(a) provides that self-correction is not available if:

(1) such failure was identified by the Secretary prior to any actions which demonstrate a "specific commitment to implement a self-correction with respect to such failure," or

(1) the self-correction is not completed within a reasonable period after such failure is identified.

Under Rev. Proc. 2021-30, "insignificant" errors could still be corrected on audit, even if the above conditions were not met. It is not clear if those rules still apply after Secure 2.0.

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Are Loan errors eligible?

In the case of an eligible inadvertent failure relating to a loan from a plan to a participant—

(1) such failure may be self-corrected under according to the rules of section 6.07 of Revenue Procedure 2021–30 (or any successor guidance), including the provisions related to whether a deemed distribution must be reported on Form 1099–R;

(2) the Secretary of Labor shall treat any such failure which is so self-corrected under subsection (a) as meeting the requirements of the Voluntary Fiduciary Correction Program of the Department of Labor if, with respect to the violation of the fiduciary standards of the Employee Retirement Income Security Act of 1974, there is a similar loan error eligible for correction under EPCRS and the loan error is corrected in such manner; and

(3) the Secretary of Labor may impose reporting or other procedural requirements with respect to parties that intend to rely on the Voluntary Fiduciary Correction Program for self-corrections described in paragraph (2).

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What about IRA mistakes?

In Secure 2.0, congress directed the IRS to expand EPCRS to cover IRAs, with 2 specific requirements:

1. Waivers of the excise tax which would otherwise apply under section 4974 of the Internal Revenue Code of 1986; and
2. Rules permitting a nonspouse beneficiary to return distributions to an inherited individual retirement plan described in section 408(d)(3)(C) of the Internal Revenue Code of 1986 in a case where, due to an inadvertent error by a service provider, the beneficiary had reason to believe that the distribution could be rolled over without inclusion in income of any part of the distributed amount.

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What's Next?

Section 305(g) provides that Treasury/IRS is required to issue new guidance within 2 years to fully implement these changes:

> ISSUANCE OF GUIDANCE.—The Secretary of the Treasury, or the Secretary's delegate, shall revise Revenue Procedure 2021–30 (or any successor guidance) to take into account the provisions of this section not later than the date which is 2 years after the date of enactment of this Act.
>
> CORRECTION METHODS FOR ELIGIBLE INADVERTENT FAILURES.—The Secretary shall issue guidance on correction methods that are required to be used to correct eligible inadvertent failures, including general principles of correction if a specific correction method is not specified by the Secretary.

Soft guidance is expected before that date, but Congress has directed that a new Revenue Procedure be issued on or before 12/29/2024.

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Background - Overpayments

The rules before Secure 2.0

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What is an Overpayment?

Payments to a participant (or directly to beneficiary) that exceeds the amount that the recipient is entitled to receive under the plan terms or under applicable law.

Examples:

- miscalculated amount under the plan
- in service distribution that plan does not allow

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Ramification of Overpayments Pre-Secure 2.0

- Under ERISA: Possible breach of fiduciary duty -- No explicit fiduciary rule requiring recoupment of overpayment but ERISA fiduciary provisions generally interpreted to impose fiduciary duty on plan fiduciaries to take steps to recoup overpayments since monies to which a participant is not entitled constitute plan assets and the overpayment was often viewed as an impermissible "alienation" of benefits.
- Under Code: Since benefits are required to be provided in accordance with plan, from compliance perspective, overpayment constitutes a failure to follow plan terms/plan qualification failure that could result in plan disqualification if not corrected through EPCRS.

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What did EPCRS Require Pre – Secure 2.0?

- EPCRS generally required plan sponsor to take steps to recoup overpayments(except for de minimum overpayments) from participants/beneficiaries by seeking the return of the overpayments to a plan and to provide notices to participants regarding tax consequences (i.e. not eligible to be rolled over).
- EPCRS also permit plan sponsor to forgo seeking recoupment from the recipients in certain circumstances but the sponsor (or other responsible party) still had to restore the overpaid amount to the plan.

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Secure 2.0

- ERISA amended to add ERISA 206(h) to expressly provide that plan fiduciary will not "be considered to have" breached its fiduciary duty if a plan fiduciary decides, in proper exercise of discretion, not to recoup all or part of an "inadvertent" overpayment from participant (plan sponsor, contributing employer and other fiduciaries who didn't cause the overpayment) if specific new requirements are met.
- Code amended to expressly provide that there will be no qualification failure if overpayments are not recouped or if the sponsor decides to amend the plan (even retroactively to increase prior benefits or decrease future benefits to adjust for the overpayments) if specific requirements are met.

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Requirements of new ERISA 206(h)

If the plan administrator does determine to recoup, there are limitations on recoupment from participant/beneficiary:

a. No interest or other collection amounts
b. No recourse against beneficiary for overpayments made to participant
c. No recoupment if first overpayment occurred more than three years before notice of the overpayment
d. No litigation threat/use of collection agency except in limited circumstances
e. Recipient right to contest recoupment through claims procedures
f. Hardship on recipient may be considered
g. Special rules regarding recouping overpayments of an annuity via future benefit payments reductions/installment payments
h. Must follow Secretary of Labor requirements (if not from an annuity)

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Requirements of new ERISA 206(h)

How does the claims procedures work if the overpayment has been transferred/rolled over to another eligible retirement plan?

1. The recipient must utilize claims procedures of the plan that made the overpayment and is seeking recoupment.
2. The recouping plan, upon receipt of a claim, must notify the plan that has received the overpayment.
3. If recouping plan determines that in fact there was an overpayment, overpayment may be returned from the plan to which it was transferred.

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Requirements of new ERISA 206(h)

Special rules for recoupment of an annuity:

1. If reducing future benefit payments:
   a) The reduction ceases after the full amount of the overpayment is recovered
   b) The amount recouped each calendar year may not exceed 10% of overpayment
   c) Further benefit payment may not be reduced below 90% of the periodic amount otherwise payable under the terms of the plan
2. If, instead of reducing future benefit payments, the plan administrator decides to recoup an overpayment through installment payments, the sum of the installments in any calendar year can't exceed the sum of the reductions that would have been made each year under a–c above.

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Requirements of new ERISA 206(h)

If the participant is "culpable", none of the above protection/limitations apply (except for recipient's right to contest through claims procedures and plan consideration of recipient's hardship)

Secure 2.0 defines "culpable" to mean when participant:

A. "bears responsibility for the overpayment (such as through misrepresentations or omissions that led to the overpayment"; or
B. "knew that the benefit payment or payments were or might be materially in excess of the correct amount" **but** participant is not "culpable" if:
    1. they merely believed the benefit payment or payments were or might be materially in excess of the correct amount";
    2. they raised the question with an authorized plan representative; and
    3. they were told the payments or payments were not in excess of the correct amount.

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Requirements of new ERISA 206(h)

Limitations on determining not to recoup from a plan sponsor or contributing employer under ERISA:

1. No Secure 2.0 relief from liability if recoupment necessary to prevent or restore an impermissible forfeiture from a participant account.

1. No Secure 2.0 relief from liability if failure to recoup would prevent DB plan from paying out benefits to other participants/beneficiaries or impact minimum funding.

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Requirements of new ERISA 206(h)

Limitations on exercising discretion not to recoup overpayments from another fiduciary:

1. If the plan has established prudent procedures to prevent and minimize overpayments and the "relevant" plan fiduciaries have followed such procedures, a decision that otherwise complies with ERISA not to recoup an inadvertent benefit overpayment would not be a breach of fiduciary duty.
2. However, if the "relevant" plan fiduciary breached their fiduciary duties and the breach resulted in the overpayment, it may also be a breach of fiduciary duty to not seek recoupment of the overpayment from the breaching fiduciary.

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Overpayment Relief Under New Code section 414 (aa)

New Code Section 414(aa) provides that a plan will not fail to be treated as qualified, whether the sponsor seeks recoupment of the overpayment or not, "merely because":

1. the plan fails to obtain payment from any participant, beneficiary, employer, plan sponsor, fiduciary, or other party on account of any inadvertent benefit overpayment or
2. Sponsor amends the plan to increase past benefits or decrease future benefits, to the affected participants and beneficiaries to adjust for prior inadvertent benefit overpayments.

Note --the overpayment must be inadvertent.

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Overpayment Relief Under New Code section 414 (aa)

- New Code Section 414(aa) expressly provides that the amendment:
  1. does not relieve employer of obligation to contribute or to prevent or restore impermissible forfeiture; and
  2. does not change the other obligations regarding IRC section 401(a)(17) or section 415 limitations.
- New Code Section 414(aa) authorizes IRS to provide regulations or other guidance on both how these limitations are enforced and every other aspect of how "benefit payments and their recoupment or non-recoupment" shall be "taken into account for purposes of satisfying any requirements applicable to a plan."

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Overpayment Relief Under New Code section 402 (c) (12)

New Code Section 402(c)(12) provides rollover (and likely excess contribution penalty) relief:

1. If recoupment of overpayment is not sought, overpayment is still treated as eligible for rollover (if payment would have been eligible but for the overpayment).
2. If recoupment of overpayment is sought, overpayment can be returned to the plan and treated as eligible rollover distribution back into the plan.

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Impact on Pre – Secure 2.0 Overpayment Determinations/Recoupments in Process

- Secure 2.0 overpayment provisions were effective "as of the date of the enactment" of Secure 2.0. This means they are already effective.
- How does effective date impact overpayments determinations/recoupments pre -Secure 2.0?

Secure 2.0 expressly answers this question: "Plans, fiduciaries, employers, and plan sponsors are entitled to rely on":

1. "A reasonable good faith interpretation of then existing administrative guidance for inadvertent benefit overpayment recoupments and recoveries that commenced before" enactment and
2. Determinations made before enactment by responsible plan fiduciary, in the exercise of its fiduciary discretion, not to seek recoupment or recover all or part of overpayment.
3. Recovery of overpayments that were in process prior to enactment "may" continue after the effective date.

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Next Steps After Secure 2.0

Some Practical Tips

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What Should Plan Sponsors Do Now?

1. Stay tuned – new guidance is expected from the IRS and DOL as directed by Congress in Secure 2.0 and to implement and interpret Secure 2.0.
2. Check plan operations:
   a) Does the plan have good administrative practices and procedures?
   b) Are there any overpayment situations that need to be reviewed?
   c) Have you demonstrated and documented a commitment to correction?
   d) Are you acting within a reasonable time period?
3. Check with insurance brokers – does your voluntary correction rider need to be updated to reflect the new law?

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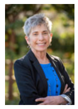

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