Earnings adjustments for corrective contributions

IRS Revenue Procedure 2013-12 Appendix B provides guidance for calculating lost earnings that must be allocated with certain corrective contributions.

Note:
- This guidance applies only to corrective contributions made to defined contribution plans. It does not apply to corrective contributions made to defined benefit plans or to corrective distributions or reductions of participant account balances.
- Use of these guidelines to calculate allocable earnings will be deemed acceptable by the IRS. However, other earnings calculation methods may be used, if they are appropriate for the situation, bearing in mind that they have not been deemed as acceptable methods of calculating earnings by the IRS.
- If the difference between a precise calculation (as described below) and an approximate calculation is likely to be insignificant and the cost of the precise calculation significantly exceeds the probable difference, the plan sponsor may use reasonable estimates to calculate lost earnings. There are no specific thresholds for determining “insignificance.” If it is not feasible to make a reasonable estimate of what the actual investment results would have been, a reasonable interest rate may be used. For this purpose, the interest rate used by the Department of Labor’s Voluntary Fiduciary Correction Program Online Calculator (“VFCP Online Calculator”) is deemed to be a reasonable interest rate.

Guidelines for calculating earnings adjustments

In general, earnings should be calculated and allocated to participant accounts to make the value of the account equal what it would have had the error not occurred. To accomplish this, the calculation must consider the correct earnings rate for the appropriate period of error.

Earnings rate

In general, the appropriate earnings rate is the actual investment result that would have applied to the corrective contribution or allocation if the error had not occurred. However, it is permissible to use the rate of return for the fund with the highest rate of return under the plan for the period of the error if:
- The plan allows employees to direct the investment of their accounts into more than one investment fund, and
- Most of the employees receiving the corrective contribution are NHCEs.

If the above conditions are met, but an affected employee did not make investment choices, the earnings adjustment calculation may use the earnings rate under the plan as a whole (i.e., the average of the rates earned by all of the funds during the period of error, weighted by the portion of plan assets invested in the various funds during that period).
Period of error

In general, the period of error begins on the date the error started and ends on the date of the correction. However, when an eligible employee does not receive a plan contribution, the beginning of the period for which lost earnings are calculated is the date on which that type of contribution (i.e., elective deferrals, matching contributions, nonelective contributions) was made for other employees for the year of the error.

In cases where an eligible employee was improperly excluded from making periodic elective deferrals or after-tax contributions, or from receiving periodic matching contributions, for administrative convenience, the employer can use the midpoint of the plan year (or the midpoint of the portion of the plan year) in which the error occurred as the date on which the contributions would have been made. Alternatively, the employer may use the first day of the plan year (or portion of the plan year) in which the error occurred as the date on which contributions would have been made. If the second method is chosen, the employer must use half of the earnings rate (as defined above) applicable for the plan year (or portion of the plan year) of the error.