CIGNA Retirement & Investment Services

CIGNA'S Pension ANALYST

Errors and Acceptable Correction Methods, Index

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Error and Acceptable Correction Methods

The Following Correction Methods are Available Under Both the ***SCP*** *and the* ***VCP***.

IRS Revenue Procedure 2003-44 lists a number of errors that can be corrected under the various programs and some specific correction methods that are deemed acceptable to correct these errors. The list is only a sample of the errors that can be corrected under the EPCRS. Many other types of errors commonly occur and can be corrected using the EPCRS, but the IRS has not published specific correction methods. The list of correction methods below was created to give employers sponsoring qualified pension, profit sharing and stock bonus plans guidance about acceptable correction methods for some of the most common errors and may be expanded as the IRS sees fit.

The errors listed can also be corrected using a method other than that shown below. However, any other correction method must meet the *General Correction Principles under the EPCRS*, and any employer interested in using an EPCRS program must meet that program's eligibility requirements (see *IRS Employee Plans Compliance Resolution System (EPCRS) Options*).

Error	Acceptable Correction Method	Example
1 Failure to properly provide the minimum top-heavy benefit or contribution to non-key employees.	***Defined Contribution Plan:*** The plan sponsor must properly contribute and allocate the required top-heavy minimums to the plan in the manner provided for in the plan on behalf of the non-key employees (and any other employees required to receive top-heavy allocations under the plan). The corrective allocation must include lost earnings. ***Defined Benefit Plan:*** The non-key employees must accrue the minimum required benefit in the manner provided in the plan.	• Employer A maintains only a profit sharing plan that provides for elective deferrals and nonelective contributions. • Employer A did not make a profit sharing contribution for 1999. • In 2001, Employer A discovers that the plan was top-heavy for 1999, and the Employer did not make the minimum required contribution. → In 2001, Employer A contributes the top-heavy minimum to the plan: → 3% of compensation, adjusted for lost earnings, to each non-key individual employed on the last day of the 1999 plan year.

Error and Acceptable Correction Methods

*The Following Correction Methods are Available Under Both the **SCP** and the **VCP**.*

Error	Acceptable Correction Method	Example
2 Failure to satisfy the ADP test, the ACP test, or the multiple use test. [Option 1]	***QNEC Method:*** The plan sponsor must make qualified nonelective contributions (QNECs) to nonhighly compensated employees (NHCEs) to the extent necessary to raise the ADP or ACP of the NHCEs to the percentage needed to pass the test or tests. These contributions must: • Be made on behalf of all eligible NHCEs (to the extent that the Code section 415 limits on annual additions are not exceeded); and • Either be - The same flat dollar amount, or - The same percentage of compensation; and • Include lost earnings. The plan sponsor does not have to match the QNECs made to satisfy the ADP test. However, employees who would have been eligible for a matching contribution if they had made elective deferral contributions must be counted as eligible employees for the ACP test, and the plan must satisfy the ACP test. Under this correction method, a plan may not be treated as two separate plans, one covering otherwise excludable employees and the other covering all other employees to reduce the number of employees eligible to receive QNECs. Likewise, under this correction method, the plan may not be restructured into component plans (as permitted for plan years before January 1, 1992) to reduce the number of employees eligible to receive QNECs.	• Employer Q maintains a 401(k) plan that uses the current year ADP testing method. • The plan does not provide for matching or after-tax contributions. • In 1999, it was discovered that testing for 1997 was performed incorrectly. • When rerun, the 1997 ADP test was not satisfied. • The 1997 HCE ADP was 9%. • The 1997 NHCE ADP was 4%. • The plan would not have passed the ADP test if the prior year method was used. → Employer Q must make a QNEC to eligible NHCEs to raise the NHCE ADP to 7%. → Employer Q calculates the amount to be $5000. → The $5000 QNEC is allocated to all eligible NHCEs, giving the same flat dollar amount to each. → The amount allocated to each account includes lost earnings.

Error	Acceptable Correction Method	Example
3 Failure to satisfy the ADP test, the ACP test, or the multiple use test. [Option 2]	***One-to-One Method:*** The plan sponsor **a)** Distributes the excess amounts to the highly compensated employees (HCEs), and **b)** Allocates an equal amount as a QNEC to the non-highly compensated employees (NHCEs). The excess amount to be returned to an HCE is the sum of any excesses determined from the ADP, ACP and multiple use tests, adjusted for earnings through the date of the correction. Any amounts that were not vested as of the close of the plan year of the error are forfeited. Amounts forfeited are used according to the plan's forfeiture provisions in place for the year of the error. If an excess amount has already been distributed to an HCE, the employer must notify the employee that the distribution was not eligible for favorable tax treatment, such as a tax-free rollover. If an excess matching amount that should have been forfeited has been paid to an HCE, this amount is an Overpayment that must be corrected (see *Failure to satisfy the defined contribution annual additions limit, where the portion of the excess attributable to matching and nonelective contributions has already been distributed*). The total QNEC amount to be allocated to NHCEs is the sum of all excess contributions adjusted for earnings through the date of the correction, excluding forfeited related matching contributions. The plan sponsor must pick the group of employees who will receive the contribution from the following choices*:	• Employer T maintains a 401(k) plan that uses the current year ADP testing method. • The plan provides for matching and after-tax contributions. • Matching contributions equal 50% of the sum of elective deferrals and after-tax contributions that do not exceed 10% of the employee's compensation. • Matching contributions are subject to a 5-year graded vesting schedule. • Matching contributions are forfeited and used to reduce employer contributions if associated elective deferrals or after-tax contributions are distributed to correct an ADP, ACP or multiple use test failure. • For 1997, only NHCEs made after-tax contributions. • Two HCEs were eligible in 1997, Employee P and Employee S. • Employee P made elective deferrals of $8,000, which was 10% of his compensation for 1997 ($80,000). • Employee S made elective deferrals of $9,500, which was 8% of his 1997 compensation ($118,750). • Employee P received a matching contribution of $4,000 (50% of $8,000). • Employee S received a matching contribution of $4,750 (50% of $9,500). • Employees P and S were 100% vested in 1997.

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Error	Acceptable Correction Method	Example
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	• Individuals who were eligible to participate and were NHCEs in the year of the error. • Individuals who were eligible to participate and were NHCEs both in the year of the error and the year of correction. • Individuals who were eligible to participate and were NHCEs in the year of the error, but who are still employees as of a date in the year of correction that is no later than the date of correction. • Individuals who were eligible to participate and were NHCEs both in the year of the error and the year of correction, but who are still employees as of a date in the year of correction that is no later than the date of correction. *The four options listed above assume the plan sponsor uses the current year testing method. If the prior year testing method is used, substitute "the year prior to the year of the error" for "the year of the error" in the dot points above. Regardless which group the employer selects to receive the contribution, it is allocated to each employee either as: • The same flat dollar amount, or • The same percentage of compensation. The allocation is not adjusted further for earnings. It is treated as an annual addition for the year of the error. Under this correction method, a plan may not be treated as two separate plans, one covering otherwise excludable employees and the other covering all other employees to reduce the number of employees eligible to receive QNECs. Likewise, restructuring the plan into component plans is *not* permitted to reduce the number of employees eligible to receive QNECs.	• In 1999, it was discovered that testing for 1997 was performed incorrectly. • When rerun, the 1997 ADP test was not satisfied. • The 1997 HCE ADP was 9%. • The 1997 NHCE ADP was 4%. • The plan would not have passed the ADP test if the prior year method was used. The ACP and multiple use tests would have been satisfied for 1997 without any corrective action. → Employer T calculates the dollar amount of the excess contributions for the two HCEs. → The excess contribution for Employee P is $2,037.50. → The earnings on Employee P's excess are $407. → Employee P receives a distribution of $2,444.50 ($2037.50 plus $407). → The excess contribution for Employee S is $3,537.50. → The earnings of Employee S's excess are $707. → Employee S receives a distribution of $4,244.50 ($3,537.50 plus $707). → The total of the excesses, adjusted for earnings, is $6,689. → Employer T makes a corrective contribution to the plan in the amount of $6,689. → The corrective contribution is allocated to eligible NHCEs for 1997, pro rata based on 1997 compensation.

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Error	Acceptable Correction Method	Example
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		→ Employee P's and Employee S's matching contributions related to the distributed excesses, adjusted for earnings, are forfeited. → The forfeited amounts are used to reduce contributions for 1999 and subsequent years.
4 Failure to distribute elective deferrals in excess of the section 402(g) limit.	The plan must distribute the excess deferral, and allocable earnings, to the employee and report the amount as taxable in the year of deferral and the year distributed. A distribution to a highly compensated employee is included in the ADP test. A distribution to a nonhighly compensated employee is *not* included in the ADP test.	• Employer P maintains a 401(k) plan. • Employee W (an HCE) and Employee U (a NHCE) each exceeded the section 402(g) deferral limit of $10,500 in 2000. • The error is discovered in May of 2001. → The 2000 Form W-2 for Employee W and Employee U will reflect deferrals greater than $10,500. The employees will be allowed to defer taxation on only $10,500 when they file their tax return. The employees will need to report the excess as taxable income in 2000. → The amounts deferred above $10,500, adjusted for earnings, are removed from the accounts and distributed to Employee W and Employee U in 2001. → Employee W and Employee U will receive a 2001 Form 1099R showing the excess amounts removed, and allocable earnings, as taxable in 2001. → The excess amount distributed to Employee W is included in the 2000 ADP test. → The excess amount distributed to Employee U is not included in the 2000 ADP test.

Error	Acceptable Correction Method	Example
5 Exclusion of an eligible employee from making elective deferrals or employee post-tax contributions, or from receiving matching contributions for one or more plan years.	***Defined Contribution Plan:*** The plan sponsor must make a contribution to the plan on behalf of the excluded employees. The corrective contributions must include lost earnings. If the employee was eligible to make an elective deferral contribution under a 401(k) plan, the plan sponsor must make a QNEC to the plan for the employee that is equal to the ADP for the employee's group (either HCE or NHCE). If the employee was eligible to make employee post-tax contributions or to receive matching contributions (on either elective deferral contributions or employee post-tax contributions), the employer must make a QNEC to the plan for the employee that is equal to the ACP for the employee's group (either HCE or NHCE). Contributing the ADP or ACP for such employees eliminates the need to rerun the ADP or ACP test to account for the previously excluded employees. Under this correction method, a plan may *not* be treated as two separate plans, one covering otherwise excludable employees and the other covering all other employees to reduce the number of employees eligible to receive QNECs. Likewise, restructuring the plan into component plans is *not* permitted to reduce the number of employees eligible to receive QNECs. *Defined benefit plan:* The excluded employees must accrue their lost benefits.	• Employer B maintains a 401(k) plan. • Employees may enter the plan on the January 1 or July 1 following the completion of one year of service. • Twelve employees (8 NHCEs and 4 HCEs) who completed one year of service in 1995 were not allowed to enter the plan on January 1, 1996. • These employees were allowed to enter the plan on January 1, 1997. • For 1996, the ADP for the HCEs was 8% and the ACP for HCEs was 2.5% • For 1996, the ADP for NHCEs was 6% and the ACP for NHCEs was 2%. • The error was discovered in 1998. → Employer B makes a QNEC for each of the excluded employees. → The excluded HCEs receive 10.5% (the HCE ADP plus HCE ACP) of the employee's plan compensation for the 1996 plan year, adjusted for earnings. → The excluded NHCEs receive 8% (the NHCE ADP plus NHCE ACP) of the employee's plan compensation for the 1996 plan year, adjusted for earnings.

Error	Acceptable Correction Method	Example
6 Exclusion of an employee eligible to participate in a defined contribution plan from making elective deferrals or employee post-tax contributions, or from receiving matching contributions for less than one year.	**Exclusion for More than 3 Months but less than One Year** The plan sponsor must make a contribution to the plan on behalf of the excluded employees. The corrective contributions must include lost earnings. If the employee was eligible to make an elective deferral contribution under a 401(k) plan, the plan sponsor must make a QNEC to the plan for the employee that is equal to the ADP for the employee's group (either HCE or NHCE) multiplied by compensation for the time period the exclusion occurred. Compensation can be prorated for this purpose. The amount of the QNEC cannot exceed the maximum amount of deferrals allowed for that employee for that plan year, minus deferrals the participant actually made that year. If the employee was eligible to make employee post-tax contributions or to receive matching contributions (on either elective deferral contributions or employee post-tax contributions), the employer must make a QNEC to the plan for the employee that is equal to the ACP for the employee's group (either HCE or NHCE) multiplied by compensation for the time period the exclusion occurred. Compensation can be prorated for this purpose. The maximum QNEC that can be made to correct missed matching contributions and employee post-tax contributions is equal to the sum of the matching contributions that would have been made for the employee if the employee had contributed the maximum matchable contributions permitted and the maximum post-tax contributions permitted under the plan for the plan year, minus matching and/or post-tax contributions already made for/by the participant that plan year.	**Example for Exclusion for More than 3 Months but less than One Year** • Employer C's 401(k) plan allows employees to enter on the January 1 or July 1 after completing one year of service. • The plan provides for matching contributions of 100% of elective deferrals, up to 2% of compensation per payroll period. • An NHCE should have entered the plan on January 1, 1996, but was not offered plan participation. • The error was discovered in August 1996 and the employee was allowed to participate as of September 1, 1996. • The employee made elective deferrals of 4% of compensation for each payroll period from September 1, 1996 to December 31, 1996. • The employee's plan compensation for 1996 was $36,000 ($23,500 for the first eight months and $12,500 for the last four months). • Employer C made $250 in matching contributions to the excluded employee, which is 2% of the employee's plan compensation for each payroll period from September 1, 1996 to December 31, 1996 ($12,500). • The 1996 NHCE ADP was 3%. • The 1996 NHCE ACP was 1.8%. → Employer C makes a QNEC for the excluded employee to make up the missed elective deferrals and matching contributions.

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Error	Acceptable Correction Method	Example
	Under this correction method, a plan may *not* be treated as two separate plans, one covering otherwise excludable employees and the other covering all other employees to reduce the number of employees eligible to receive QNECs. Likewise, restructuring the plan into component plans is *not* permitted to reduce the number of employees eligible to receive QNECs. Unlike the full year exclusion correction with QNECs, the plan sponsor must re-run the ADP and ACP tests after the corrective contributions are made. **Exclusion for 3 Months or Less in a Plan Year** If the employee is allowed to make deferrals for at least the last 9 months of the plan year in an amount at least equal to the maximum permitted if no error occurred, then the employer is not required to make a corrective contribution with respect to elective deferrals. However, the employer is still required to make a QNEC to correct missed employee post-tax and matching contributions. The corrective contributions must include lost earnings. The employer must make a QNEC to the plan for the employee that is equal to the ACP for the employee's group (either highly compensated or nonhighly compensated) multiplied by compensation for the time period the exclusion occurred. Compensation can be prorated for this purpose. The maximum QNEC that can be made to correct missed matching contributions and employee post-tax contributions is equal to the	→ To calculate the QNEC, the employer pro-rates the employee's plan compensation for the eight-month period that the employee was improperly excluded (8/12ths of $36,000, or $24,000). → The QNEC to make up missed deferrals is $720 (3% NHCE ADP times $24,000), adjusted for earnings. → The QNEC to make up missed matching contributions is $432 (1.8% NHCE ACP times $24,000), adjusted for earnings. → The employer must determine whether $432 exceeds the maximum QNEC allowed. The matching contribution available to the employee had the employee made the maximum matchable contributions is $720 (2% of $36,000). Since the difference of this amount and the matching contributions actually made for the employee from September through December ($250) is greater than $432; the employee can receive a QNEC for $432 without exceeding the maximum QNEC amount. → Employer C reruns the ADP and ACP tests for 1996 and determines that they were satisfied. **Example for Exclusion for 3 Months or Less in a Plan Year** • Employer C's 401(k) plan allows employees to enter the plan on the January 1 or July 1 after completing one year of service.

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Error	Acceptable Correction Method	Example
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	sum of the matching contributions that would have been made for the employee if the employee had contributed the maximum matchable contributions permitted and the maximum post-tax contributions permitted under the plan for the plan year, minus matching and/or post-tax contributions already made for/by the participant that plan year. Under this correction method, a plan may *not* be treated as two separate plans, one covering otherwise excludable employees and the other covering all other employees to reduce the number of employees eligible to receive QNECs. Likewise, restructuring the plan into component plans is *not* permitted to reduce the number of employees eligible to receive QNECs. The plan sponsor must re-run the ACP test after the corrective contributions are made.	• The plan provides for matching contributions of 100% of elective deferrals, up to 2% of compensation per payroll period. • An NHCE should have entered the plan on January 1, 1996, but was not offered plan participation. • The error was discovered in March 1996 and the employee was allowed to participate as of April 1, 1996. • The amount the employee was allowed to defer was not less than the maximum deferrals the employee could have made if given the opportunity to defer on January 1, 1996. • The employee made elective deferrals of 4% of compensation for each payroll period from April 1, 1996 to December 31, 1996. • The employee's plan compensation for 1996 was $36,000 ($8,000 for the first three months and $28,000 for the last nine months). • Employer C made $560 in matching contributions to the excluded employee, which is 2% of the employee's plan compensation for each payroll period from April 1, 1996 to December 31, 1996 ($28,000). • The 1996 NHCE ADP was 3%. • The 1996 NHCE ACP was 1.8%. → Since the employee was given the opportunity to defer for at least the last 9 months of the plan year, Employer C is not required to make a corrective contribution to make up missed deferrals.

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Error	Acceptable Correction Method	Example
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		→ Employer C does need to make a corrective contribution to make up missed matching contributions. → The corrective contribution must include lost earnings. → To calculate the QNEC, the employer pro-rates the employee's plan compensation for the three-month period that the employee was improperly excluded (3/12ths of $36,000, or $9,000). → The amount of the QNEC calculated to make up missed matching contributions is $162 (1.8% NHCE ACP times $9,000), adjusted for earnings. → The employer must determine whether $162 exceeds the maximum QNEC allowed. The matching contribution available to the employee had the employee made the maximum matchable contributions is $720 (2% of $36,000). The difference of this amount and the matching contributions actually made for the employee from April through December ($560) is $160. Since the QNEC cannot exceed $160, Employer C makes a QNEC for $160 rather than $162. Employer C re-runs the ACP test for 1996 and determines that it was satisfied.

Error	Acceptable Correction Method	Example
7 Exclusion of an eligible employee from receiving a profit sharing contribution. [Option 1]	The employer must make a corrective contribution for the amount the participant would have received under the plan's allocation formula for that year. The corrective contribution must include lost earnings. If the exclusion of one employee caused another employee to receive more than he would have if the original contribution were properly allocated, the second employee's account does not have to be reduced.	• Employer D maintains a profit sharing plan that provides for a nonelective contribution which is allocated in the ratio that each eligible employee's compensation bears to the compensation of all eligible employees for the plan year. • Employer D made a contribution for the 1997 plan year. • Five eligible employees were excluded from the allocation. • Employees who did receive the contribution received 10% of compensation. • Most of the employees who received the contribution were NHCEs. • If the five excluded employees had been included, all eligible employees would have received an allocation of 9% of compensation. → Employer D makes a corrective contribution to the five excluded employees equal to 10% of each employee's compensation, adjusted for earnings.
8 Exclusion of an eligible employee from receiving a profit sharing contribution. [Option 2]	The employer must make a corrective contribution for the amount the participant would have received under the plan's allocation formula for that year. The corrective contribution must include lost earnings. In addition, the account balance of each employee who received more in the original allocation than he would have if the error had	• Employer D maintains a profit sharing plan that provides for a nonelective contribution, which is allocated in the ratio that each eligible employee's compensation bears to the compensation of all eligible employees for the plan year. • Employer D made a contribution for the 1997 plan year.

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Error	Acceptable Correction Method	Example
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	not occurred is reduced by that excess amount, adjusted for earnings. With respect to the adjustment for earnings, the following guidelines apply: • If most of the employees whose accounts are being reduced are NHCEs and there was an overall investment gain for the period from the date of the original contribution to the correction, the accounts do not have to be adjusted for earnings. • If most of the employees whose accounts are being reduced are NHCEs and the accounts are adjusted for earnings, the employer can use the lowest earnings rate for any fund from the period from the original contribution to the correction. If an employee took a distribution before the date of the correction, that employee may keep that distribution if most of the employees who took distributions are NHCEs. If the total amount of contributions to be made for excluded employees is less than the total amount of decreases in accounts, the amount by which employees' accounts are reduced is decreased on a pro-rata basis until the reductions equal the contribution amount and the employer does not have to make additional contributions.	• Five eligible employees were excluded from the allocation. • Employees who did receive the contribution received 10% of compensation. • Most of the employees who received the contribution were NHCEs. • If the five excluded employees had been included, all eligible employees would have received an allocation of 9% of compensation. → The account balance of each excluded employee is increased by 9% of the employee's 1997 compensation, adjusted for earnings. → The account balance of each of the eligible employees other than the excluded employees is decreased by 1% of the employee's 1997 compensation, adjusted for earnings. → Employer D determines the earnings adjustment using the earnings rate of each eligible employee's excess allocation, using reasonable, consistent assumptions. → The total of the reductions in account balances exceeds the total of required increases. → The initially determined reductions are decreased pro rata so that the total of the actual reductions in account balances equals the total of the increases in account balances, and Employer D does not make a corrective contribution.

Error and Acceptable Correction Methods

*The Following Correction Methods are Available Under Both the **SCP** and the **VCP**.*

Error	Acceptable Correction Method	Example
9 Failure to timely pay the minimum required distribution (MRD) under section 401(a)(9).	**Defined Contribution Plan.** The plan must distribute the MRDs. The amount to be distributed for each year in which the failure occurred must be determined by dividing the adjusted account balance on the applicable valuation date by the applicable divisor. For this purpose, adjusted account balance means the actual account balance, determined in accordance with section 1.401(a)(9)-5 Q&A 3 of the regulations, reduced by the amount of the total missed MRDs for prior years. **Defined Benefit Plan.** The plan must distribute the MRDs, plus an interest payment representing the loss of use of such amounts.	**Defined Contribution Plan Example:** Employer N maintains a 401(k) plan. Employee C, who is a 5% owner, reached 70½ in 1999. In 2001, it is discovered that no MRDs have been paid from C's account. → The plan's valuation date is 12/31 of the applicable year. → The 1999 MRD is calculated by dividing Employee N's account balance on 12/31/98 by the applicable life expectancy. → The 2000 MRD is calculated by subtracting the 1999 MRD amount from Employee N's account balance on 12/31/99, then dividing by the applicable life expectancy.
10 Failure to obtain participant and/or spousal consent for a distribution subject to the participant and spousal consent rules.	The plan must give each affected participant a choice between • Providing informed consent for the distribution actually made, or • Receiving a qualified joint and survivor annuity (QJSA). If participant and/or spousal consent is required but cannot be obtained, the participant must receive a QJSA based on the monthly amount that would have been provided under the plan at his or her retirement date. This annuity may be actuarially reduced to take into account distributions already received by the participant. However, the portion of the QJSA payable to the spouse upon the death of the participant may not be actuarially reduced to take into account prior distributions to the participant.	• In accordance with a plan's automatic QJSA option, a married participant who retired would have received a QJSA of $600 per month payable for life with $300 per month payable to the spouse upon the participant's death. • Instead, the participant received a single-sum distribution equal to the actuarial present value of his accrued benefit under the plan. • The participant and his spouse did not consent to this distribution. → The employer gives the spouse a choice to either consent to the distribution or receive a QJSA.

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Error and Acceptable Correction Methods

*The Following Correction Methods are Available Under Both the **SCP** and the **VCP**.*

Error	Acceptable Correction Method	Example
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	As an alternative, if spousal consent is required but cannot be obtained because the spouse refuses consent, does not respond or cannot be located, the spouse is entitled to a benefit equal to the portion of the QJSA that would have been payable to the spouse upon the death of the participant had the participant received a QJSA. This spousal benefit must be provided if the spouse makes a claim.	→ If consent is not obtained, the $600 monthly annuity payable during the participant's lifetime may be actuarially reduced to consider the single sum distribution. However, the spouse is entitled to receive an annuity of $300 per month payable for life beginning at the participant's death.
11 Failure to satisfy the defined contribution annual additions limit.	For excess annual additions other than elective deferrals and employee post-tax contribution (even if the excess did not result from the allocation of forfeitures or from a reasonable error in estimating compensation), the plan must place the excess annual additions into an unallocated suspense account, to be used as an employer contribution in the succeeding year(s). While such amounts remain in the unallocated account, the plan sponsor may not make additional contributions to the plan. For excess annual additions that are elective deferrals or employee post-tax contributions, the plan must distribute the elective deferrals or employee post-tax contributions, with allocable income. Elective deferrals and employee post-tax contributions that are matched may be returned, if the matching contributions relating to such contributions are forfeited (which will also reduce excess annual additions for the affected individuals). The forfeited matching contributions must be placed into an unallocated account to be used as an employer contribution in succeeding periods.	• Employer G maintains a 401(k) plan that provides for nonelective contributions, elective deferrals, and after-tax contributions. • Nonelective contributions are subject to a 5-year cliff vesting schedule. • When an employee terminates employment, the plan provides that the nonvested account balance is forfeited after 5 years, and forfeitures are used to reduce employer contributions. • In 1998, Employee T's annual additions limit was $15,000. • Employee T received $7,500 in nonelective contributions, made elective deferral contributions of $10,000, and $500 in after-tax contributions. • Employee T's total excess annual addition was $3000. → Employer G distributes the $500 in after-tax contributions (adjusted for earnings) and $2,500 of elective deferrals (adjusted for earnings).

Error and Acceptable Correction Methods

*The Following Correction Methods are Available Under Both the **SCP** and the **VCP**.*

<table>
<tr><th>Error</th><th>Acceptable Correction Method</th><th>Example</th></tr>
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12 Failure to satisfy the defined contribution annual additions limit with respect to an NHCE …

- Who had annual additions consisting of both
  - **a)** Elective deferrals, employee after-tax contributions, or both; and
  - **b)** Matching contributions, nonelective contributions, or both.
- Whose matching and nonelective contributions equal or exceed the amount of the excess annual additions.
- Who has terminated employment with 0% vesting in the matching and nonelective contributions (and is not reemployed at the time of the correction).

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The annual additions excess is deemed to consist solely of matching and nonelective contributions.

If the excess (adjusted for earnings) has been forfeited, the error is deemed to be corrected. No further corrective action is necessary.

If the excess (adjusted for earnings) has not been forfeited, either:

- The excess amount is placed in an unallocated account to be used to reduce employer contributions in succeeding years, or
- If the amount would have been allocated to other employees for the year of the error if the error had not occurred, that amount is allocated to the other employees according to the plan's allocation formula.

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- Employer G maintains a 401(k) plan that provides for nonelective contributions, elective deferrals, and after-tax contributions.
- Nonelective contributions are subject to a 5-year cliff vesting schedule.
- When an employee terminates employment, the plan provides that the nonvested account balance is forfeited after 5 years, and forfeitures are used to reduce employer contributions.
- In 1998, Employee U's annual additions exceeded the limit by $300.
- On January 1, 1999, Employee U terminated employment with 3 years of service and received his entire vested account balance (which consisted of his elective deferrals).

→ Employee U's nonvested account balance is reduced by $300 (adjusted for earnings)

→ The $300 is placed in an unallocated suspense account to be used to reduce employer contributions in succeeding year(s).

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Error	Acceptable Correction Method	Example
13 Failure to satisfy the defined contribution annual additions limit, where the portion of the excess attributable to matching and nonelective contributions has already been distributed.	The employer takes reasonable steps to have the overpayment returned to the plan by the employee. The amount to be returned is the excess amount, including earnings to the date of distribution, plus appropriate interest from the date of distribution to the date of the repayment. If the employee does not repay the full amount of the overpayment (adjusted for earnings at the plan's earnings rate), then the employer or another person contributes the difference to the plan. The overpayment, adjusted for earnings at the plan's earnings rate to the date of repayment, is either • Placed in an unallocated account to be used to reduce employer contributions in succeeding years, or • If the amount would have been allocated to other employees for the year of the error if the error had not occurred, that amount is allocated to the other employees according to the plan's allocation formula. The employer must also notify the employee that the overpayment was not eligible for favorable tax treatment (e.g., the overpayment was not eligible for rollover).	• Employer X maintains a 401(k) plan that provides for nonelective contributions, elective deferrals, and after-tax contributions. • Nonelective contributions are subject to a 5-year cliff vesting schedule. • In 1998, Employee M's annual additions exceeded the limit by $300. • On January 1, 1999, Employee M terminated employment with 7 years of service and received his entire account balance (Employee M was 100% vested). → Employer X notifies Employee M that he was not eligible to receive a portion of the distribution and that $300 adjusted for earnings through the date of the plan distribution must be returned to the plan. This amount must also include appropriate interest from the date Employee M received the distribution to the date it is repaid to the plan. → Employer X also notifies Employee M that the overpayment (i.e., $300 adjusted for earnings) was not eligible for rollover. → Employee M repays the $300, adjusted for earnings. This amount is placed in an unallocated account to reduce employer contributions in succeeding years.

Error and Acceptable Correction Methods

*The Following Correction Methods are Available Under Both the **SCP** and the **VCP**.*

Error	Acceptable Correction Method	Example
14 Overpayments because of amounts paid in excess of the defined benefit annual benefit limit.	***Either of the Following Methods can be Used:*** **a)** The employer takes reasonable steps to have the overpayment (with appropriate interest) returned to the plan by the participant. Future benefit payments (if any) due to the recipient are reduced to reflect the annual benefit limit. If the amount returned is less than the overpayment (adjusted for earnings at the plan's earnings rate) the employer or another person contributes the difference to the plan. The employer must also notify the recipient that the overpayment was not eligible for favorable tax treatment (e.g., the overpayment was not eligible for rollover). **b)** If benefits are being distributed in periodic payments, future payments to the recipient are reduced so that they do not exceed the maximum annual benefit limit. An additional reduction is made to recoup the overpayment (over a period not longer than the remaining payment period) so that the actuarial present value of the additional reduction is equal to the overpayment plus interest at the interest rate used by the plan to determine actuarial equivalence. If the employee is receiving payments in the form of a joint and survivor annuity, with the employee's spouse to receive a life annuity upon the employee's death equal to a percentage of the amount being paid to the employee, the reduction of future annuity payments to reflect section 415(b) reduces the amount of benefits payable during the lives of both the employee and spouse, but any reduction to recoup overpayments made to the employee does not reduce the amount of the spouse's survivor benefit. Thus, the spouse's benefit will be based on the previous	<u>Example of Adjustment of Future Payments Method</u> • Employer F maintains a defined benefit plan funded solely through employer contributions. • The plan provides that the benefits of employees are limited to the maximum amount permitted under section 415(b), disregarding cost-of-living adjustments after benefit payments have started. • Employee S retired at the beginning of the 1998 plan year and started receiving an annual straight life annuity of $140,000 from the plan. • Due to an administrative error, the amount received by Employee S for 1998 included an overpayment of $10,000 (because the benefit limit for 1998 was $130,000). • The error was discovered at the beginning of 1999. • Future annuity payments to Employee S are reduced so that they do not exceed the maximum limit. • Employee S's future benefit payments from the plan are also actuarially reduced to recoup the overpayment, beginning in 1999. • The actuarial reduction for Employee S is $1,000 annually for life since the actuarial present value of a benefit of $1,000 annually for life commencing in 1999 is equal to the sum of $10,000 and interest at the rate used by the plan to determine actuarial equivalence beginning with the date of the first overpayment and ending with the date the reduced annuity payment begins.

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Error	Acceptable Correction Method	Example
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	specified percentage (e.g., 75%) of the maximum permitted under section 415(b), instead of the reduced annual periodic amount payable to the employee.	• Employee S's remaining benefit payments are reduced so the she receives $129,000 for 1999 and each year thereafter. **Example of Adjustment of Future Payments Method** • Employer F maintains a defined benefit plan funded solely through employer contributions. • The plan provides that the benefits of employees are limited to the maximum amount permitted, disregarding cost-of-living adjustments after benefit payments have started. • Employee S retired at the beginning of the 1998 plan year and started receiving an annual straight life annuity of $140,000 from the plan. • Due to an administrative error, the amount received by Employee S for 1998 included an overpayment of $10,000 (because the benefit limit for 1998 was $130,000). • The error was discovered at the beginning of 1999. → Employer F recoups the entire excess payment made in 1998 from Employee S's remaining benefit payments for 1999. → Employee S's annual annuity benefit for 1999 is reduced to $119,400 to reflect the excess benefit amounts (increased by interest) that were paid from the plan to Employee S during the 1998 plan year. → Beginning in 2000, Employee S begins to receive annual benefit payments of $130,000.

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Error	Acceptable Correction Method	Example
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		Example of Return of Overpayment Correction Employer F maintains a defined benefit plan funded solely through employer contributions. The plan provides that the benefits of employees are limited to the maximum amount permitted, disregarding cost-of-living adjustments after benefit payments have started. Employee S retired at the beginning of the 1998 plan year and received a single-sum distribution that exceeded the benefit limit by $110,000 The error was discovered at the beginning of 1999. → Employer F notifies Employee S of the $110,000 overpayment and that the overpayment was not eligible for favorable tax treatment (e.g., payment was not eligible for rollover). → The notice also asks Employee S to return the overpayment (with interest at the rate used by the plan to calculate the single-sum payment) to the plan. → Employee S pays the $110,000 (plus the requested interest) to the plan. → The plan's earnings rate for the relevant period was 2% more than the rate used by the plan to calculate the single-sum payment. Employer F contributes the difference to the plan.

Error and Acceptable Correction Methods

The Following Correction Methods are Available Under Both the ***SCP*** *and the* ***VCP****.*

Error	Acceptable Correction Method	Example
15 Vesting error in a defined contribution plan that results in forfeiture of too large a portion of the employee's account balance.	***The Following Methods can be Used.*** **a)** Contribution Correction Method The employer makes a corrective contribution to the employee whose account balance was forfeited in error in an amount equal to the improper forfeiture. The corrective contribution includes lost earnings. If the improper forfeiture resulted in an additional allocation to the account balance of another employee, no reduction is made to the account balance of that employee. **b)** Reallocation Correction Method The employer must make a corrective contribution to the account of the affected participant(s) for the amount of the improper forfeiture. The corrective contribution must include lost earnings. In addition, the account balance of each employee who received more of the forfeiture allocation than he would have if the error had not occurred is reduced by that excess amount, adjusted for earnings. With respect to the adjustment for earnings, the following guidelines apply: • If most of the employees whose accounts are being reduced are NHCEs and there was an overall investment gain for the period from the date of the original forfeiture allocation to the correction, the accounts are not required to be adjusted for earnings. • If most of the employees whose accounts are being reduced are NHCEs and the accounts are adjusted for earnings, the employer can use the lowest earnings rate for any fund from	• Employer E maintains a profit sharing plan that allows a nonelective contribution. • The plan also provides the forfeitures are reallocated among the other eligible employees, based on compensation. • In 1997, Employee R terminated employment and received a single-sum distribution of his vested benefit. • No other distributions to Employee R have been made since 1997. • The amount of the 1997 distribution was based on an incorrect vesting percentage, causing that distribution to be less than the amount to which the employee was entitled. • The remaining portion of the employee's account was forfeited and reallocated to other participants, most of whom were NHCEs. **Contribution Correction Method** → Employer E contributes the incorrectly forfeited amount (adjusted for earnings) to Employee R's account. → The balances of the employees who received a portion of the forfeiture allocation are not reduced. **Reallocation Correction Method** → Employer E contributes the incorrectly forfeited amount (adjusted for earnings) to Employee R's account.

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Error	Acceptable Correction Method	Example
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	the period from the original forfeiture allocation to the correction. If an employee took a distribution prior to the date of the correction, that employee may keep that distribution if most of the employees who took distributions are NHCEs. If the total amount of contributions to be made for employees whose accounts were improperly forfeited is less than the total amount of decreases in accounts, the amount by which employee's accounts are reduced is decreased on a pro-rata basis until the reductions equal the contribution amount.	→ The account of each employee who shared in the allocation of the improper forfeiture is reduced by the amount of the improper forfeiture allocated to his account, adjusted for earnings. → Since most of the employees whose account balances are being reduced are NHCEs, Employer E uses the earnings rate of the fund with the lowest earnings rate for the period of the error to adjust the reduction to each account. → It is determined that the amount (adjusted for earnings) of the contribution to be made to Employee R is greater than the total amount by which the other accounts are reduced. → Employer E makes a contribution to the plan equal the difference between the amount to be contributed to Employee R and the reductions to be made to the other accounts. → The reductions are made on a pro-rata basis among all funds in which the employee's account balance is invested.
16 All overpayment errors, including distributions exceeding the employee's or beneficiary's benefit under the plan due to an error in applying the compensation limit ($200,000 as indexed), an error in forfeiting nonvested ACP excesses, or an error in forfeiting matching contributions attributable to Excess Amounts.	**Overpayments from a Defined Benefit Plan** Use correction methods allowed for "Overpayments because of amounts paid in excess of the defined benefit annual benefit limit" above. **Overpayments from a Defined Contribution Plan** Use correction methods allowed for "Failure to satisfy the defined contribution annual additions limit, where the portion of the excess attributable to matching and nonelective contributions has already been distributed" above.	

Error	Acceptable Correction Method	Example
17 Allocation of contributions or forfeitures under a defined contribution plan based on compensation in excess of the compensation limit ($200,000 as indexed). [Option 1]	The account balance of the employee that received the erroneous allocation is reduced by the improper amount, adjusted for earnings. If the improper amount would have been allocated to other employees if the error had not occurred, that amount (adjusted for earnings) is reallocated to those employees according to the plan's allocation formula. If the improperly allocated amount would not have been allocated to other participants, that amount (adjusted for earnings) is placed in an unallocated account, to be used to reduce employer contributions in succeeding year(s). If an employee received a distribution that included an improperly allocated amount, refer to the section titled "Overpayment errors" for corrective options.	• Employer J maintains a money purchase plan. • Each eligible employee receives 8% of his compensation as an employer contribution under the plan. • In 1998, the compensation of one employee was not limited to $160,000 (the compensation limit in 1998), resulting in an allocation of $4800 more than what he was eligible to receive. → To correct the error, the employee's account balance is reduced by $4800 (adjusted for earnings). → The $4800 (adjusted for earnings) is placed in an unallocated suspense account to be used to reduce employer contributions in succeeding year(s).
18 Allocation of contributions or forfeitures under a defined contribution plan based on compensation in excess of the compensation limit ($200,000 as indexed). [Option 2]	The employer contributes an additional amount to each of the other employees (excluding each employee who received too large an allocation due to the error) who received an allocation for the year of the error, amending the plan (as necessary) to provide for the additional allocation. The amount contributed to these employees is equal to the employee's plan compensation multiplied by a fraction. The numerator of the fraction is the largest amount that was improperly allocated to any employee. The denominator of the fraction is the compensation limit in effect for the year the error occurred. The corrective allocation must include lost earnings.	Employer J maintains a money purchase plan. Each eligible employee receives 8% of his compensation as an employer contribution under the plan. In 1998, the compensation of one employee was not limited to $160,000 (the compensation limit in 1998), resulting in an allocation of $4800 more than what he was eligible to receive. → Employer J amends the plan to increase the contribution percentage for all eligible employees (other than the employee who received the erroneous contribution) by 3% for the 1998 plan year ($4800/$160,000 = 3%). → Employer J contributes an additional 3% (adjusted for earnings) for those employees for the 1998 plan year.

Error and Acceptable Correction Methods

*The Following Correction Methods are Available Under Both the **SCP** and the **VCP**.*

Error	Acceptable Correction Method	Example
19 Hardship distributions made under a plan that does not allow hardship distributions.	The plan is amended retroactively to allow hardship distributions. The amendment must be submitted to the IRS for determination, using the correct application form (i.e., the Form 5300 series or, if permitted, Form 6406). If the error is significant and the employer is correcting under SCP, the submission must be made before the end of the correction period. If the employer is correcting the error under VCP, a copy of the amendment, the application form, and the appropriate user fee must be sent with the VCP submission. The amendment must satisfy the qualification requirements of section 401(a) as of the effective date of the amendment, and as of the date the amendment is adopted.	• Employer K maintains a 401(k) plan that does not permit hardship distributions. • In 1998, hardship distributions were made available to all participants. • Hardships were distributed to several participants in 1998 and 1999. The error was discovered in 2000. → Employer K adopts a plan amendment to provide for hardship distributions. → The effective date of the amendment is January 1, 1998. → By making hardships available to all employees, the amendment satisfies section 401(a) at the time the amendment is adopted (2000) and would have satisfied section 401(a) if the amendment had been adopted in 1998.

Error	Acceptable Correction Method	Example
20 Inclusion of employee who has not met the plan's minimum age or service requirement or who was included too soon due to an incorrect plan entry date.	The plan is amended retroactively to allow the inclusion of the ineligible employee to reflect the plan's actual operations. Most of the employees affected by the amendment must be NHCEs. The amendment must be submitted to the IRS for determination, using the correct application form (i.e., the Form 5300 series or, if permitted, Form 6406). If the error is significant and the employer is correcting under SCP, the submission must be made before the end of the correction period. If the employer is correcting the error under VCP, a copy of the amendment, the application form, and the appropriate user fee must be sent with the VCP submission. The amendment must satisfy the qualification requirements of section 401(a) as of the effective date of the amendment, and as of the date the amendment is adopted. The amendment may change the eligibility provisions with respect to only those ineligible employees that were wrongly included.	• Employer L maintains a 401(k) plan. • Employees must have 6 months of service to enter the plan. • The plan provides for both elective deferrals and matching contributions. • In 2001, Employer L discovers that all four employees hired in 2000 were permitted to enter the plan immediately. • Three of the four affected employees are NHCEs. • The elective deferral contributions made by the four employees were matched. • The plan passed the ADP and ACP tests, taking into account the contributions made by the four employees. → Employer L corrects the error under SCP by adopting a plan amendment. → The amendment provides that employees may enter the plan immediately. → The amendment is effective for employees hired on or after January 1, 2000 that were wrongly included. → Employer L submits the amendment to the IRS for a determination letter.

Error and Acceptable Correction Methods

*The Following Correction Method is only Available Under the **VCP**.*

Error	Acceptable Correction Method	Example
21 Employer Eligibility Failure.	In general, all contributions (including salary deferrals and after-tax contributions) cease beginning no later than the date the application under VCP is filed. The assets of the plan remain in the trust, annuity contract, or custodial account and are not distributed until a distributable event (e.g., death, disability, termination of employment, etc.). The plan will still be subject to all of the 401(a) (or 403(b) if correcting a TSA plan) requirements. Contributions can continue if that continuation is not an Employer Eligibility Error (e.g., the employer is now eligible to sponsor a 401(k) plan).	• Employer Z, a tax-exempt organization, adopted a 401(k) plan in 1994. • Employer Z was not eligible to sponsor a 401(k) plan in 1994 due to its tax-exempt status. • Employer Z discovers the error in 2001 and files a submission to correct the error under VCP. → Because Employer Z is eligible to maintain a 401(k) plan in 2001, contributions are allowed to continue. → The 401(k) plan must still meet all section 401(a) qualification requirements, and any operational, demographic, or plan document errors must be corrected with the VCP submission.