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Self-Help: The IRS Provides Interim Guidance for Self-Correction under the SECURE Act 2.0

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The IRS recently issued Notice 2023-43 providing new *interim* guidance for self-correction of plan errors. This guidance applies to corrections made prior to the anticipated issuance of revisions to the Employee Plans Compliance Resolution System ("**EPCRS**"). Under this guidance, provided certain conditions are satisfied, most Eligible Inadvertent Failures (defined below) may be self-corrected, though there are specific types of failures that may not be self-corrected at this time (discussed below).

Background

Self-correction allows plans and plan sponsors to fix these failures without paying a fee and submitting an application under the IRS's Voluntary Compliance Program ("**VCP**"). Traditionally, the EPCRS has set forth the specific circumstances in which self-correction is permissible. Over the years, as new versions of the EPCRS have been issued these circumstances have been expanded. The current version of the EPCRS (set forth in Rev. Proc. 2021-30), allows self-correction of most operational problems and certain plan document failures, provided the failures are "insignificant" or are corrected within a specified window after the failure occurred.

Section 305(a) of the SECURE 2.0 Act, passed at the end of last year, further expands the circumstances in which self-correction is permitted. Absent specific rules to the contrary, Section 305(a) allows for any eligible inadvertent failure to comply with the rules applicable under Section 401(a) 403(a), 403(b), 408(p), or 408(k) of the Internal Revenue Code of 1986, as amended (the "**Code**") to be self-corrected unless (i) the failure was identified by the Secretary prior to actions demonstrating a specific commitment to implement a self-correction, or (ii) the self-correction is not completed within a reasonable period after identification of the failure. The SECURE 2.0 Act also directed the IRS to update the EPCRS accordingly, no later than 2 years after its enactment on December 29, 2022.

Interim Guidance on Self-Correction in Notice 2023-43

Notice 2023-43 addresses self-correction of "**Eligible Inadvertent Failures**" prior to the SECURE 2.0 update to the EPCRS. Eligible Inadvertent Failures are failures that occur despite the existence of routinely followed practices and procedures (formal or informal) that are reasonably designed to promote and facilitate overall compliance in form and operation with applicable requirements under the Code. A failure will be considered an Inadvertent Eligible Failure if, despite such procedures, the failure as a result of an oversight or mistake in applying them or because the procedures were reasonable, but not sufficient to prevent the failure.

A couple of items to note:

- This post summarizes the interim guidance with respect qualified plans and 403(b) plans. It does not address specifics related to SEPs and SIMPLE IRAs. The interim guidance indicates that for the time being, IRAs may not be self-corrected.
- This interim guidance does not impose any new recordkeeping requirements, but plan sponsors that choose to self-correct must comply with the existing requirements. Accordingly, a plan sponsor must be able to provide the following, should it be requested upon an examination: (1) the date the failure was identified, the years the failure occurred, and the number of employees affected; (2) an explanation of how the failure occurred and a demonstration of established practices and procedures in effect when the failure occurred; (3) identification and substantiation of the correction method and date the correction was completed; and (4) identification of any changes made to the established practices and procedures to ensure the same failure will not recur.

Correction of Eligible Inadvertent Failures Generally.

Subject to the exceptions listed below, an Eligible Inadvertent Failure may be self-corrected if the following conditions are satisfied:

(1) **For significant failures, the failure was not identified by the Secretary before actions are taken that demonstrate a specific commitment to implement a self-correction.** An Eligible Inadvertent Failure is considered "identified by the Secretary" at the time the plan or plan sponsor comes under examination. Whether there was a specific commitment to implement a self-correction is a facts and circumstances analysis. Completion of an annual compliance audit or adoption of a general statement of intent to correct failures when they are discovered will not be sufficient to demonstrate such a commitment.

Insignificant failures may be self-corrected even if the plan sponsor is under examination. Whether a failure is significant or insignificant depends on the following factors, although no single factor is determinative:

- Whether other failures occurred within the period;
- The percentage of plan assets and contributions involved in the failure;
- The duration of the failure;
- The number of participants affected relative to the number of participants who could have been affected by the failure;
- Whether the correction was made promptly; and
- The reason behind the failure (*e.g.*, data error, minor arithmetic mistakes).

(2) **The self-correction is completed within a reasonable period after the failure is identified.** Reasonability of the time period for correction is based on the facts and circumstances, but the interim guidance outlines some safe harbors. If failure is an employer eligibility failure, meaning the employer did not meet the eligibility requirement to establish a 401(k) or 403(b) plan (as applicable), the plan sponsor must halt all contributions the plan as soon as reasonably practicable, but no later than 6 months following identification of the failure. All other Eligible Inadvertent Failures will be considered corrected within a reasonable period of time if corrected by the last day of the 18th month following identification of the failure.

(3) **The failure is not egregious, does not relate to an abusive tax avoidance transaction, and does not relate to the diversion or misuse of plan assets.** Egregious failures include: (i) consistently and improperly covering only highly compensated employees; (ii) benefits favoring an owner based on a collective bargaining agreement absent good faith bargaining; and (iii) defined contribution plan contributions for a highly compensated employee that are several times greater than the Code Section 415 limit.

(4) **The correction satisfies the current EPCRS self-correction requirements, except as noted below.** *g.*, having practices and procedures that aim to ensure compliance with the Code and following the EPCRS's general correction principles.

The interim guidance specifically includes corrections of Eligible Inadvertent Failures relating to plan loans (even those that were previously ineligible for self-correction), provided they are corrected in accordance with the EPCRS general correction principles for plan loans.

Eligible Inadvertent Failures that MAY NOT be Self-Corrected for the Time Being.

For the time being, the following Eligible Inadvertent Failures may not be self-corrected:

- A failure to initially adopt a written plan document (including the failure to adopt a written section 403(b) plan within the required time frame);
- A failure in an orphan plan;
- A significant failure in a terminated plan;
- A demographic failure corrected using methods not set forth in the Treasury Regulations;
- An operational failure corrected by a plan amendment conforming the terms of the plan to its prior operations in a manner that is less favorable for a participant or beneficiary than the original terms of the plan; and
- A failure in an ESOP that has certain tax consequences under Code Section 409.

Certain Provisions of the Current EPCRS will not Apply.

The interim guidance also outlines various self-correction provisions in the current EPCRS that will no longer apply (generally those that conflict with the expanded self-correction principles in Section 3.05 of the SECURE 2.0 Act), including:

- The requirement that the plan have a favorable determination letter;
- The general prohibitions on self-correction of demographic failures, employer eligibility failures and certain plan loan failures;
- The requirements that self-correction of significant failures be substantially completed before the plan or plan sponsor is under examination; and
- The limited correction period for significant failures (the last day of the third plan year following the plan year for which the failure occurred).

Proskauer Perspective.

Upon identifying a failure, plan sponsors should discuss with counsel whether and how to self-correct. Notice 2023-43 provides helpful guidance on additional types of failures that may be self-corrected (including certain demographic failures and plan loan failures that were previously ineligible). Moreover, the guidance provides details regarding reasonable time frames for self-correction, which are no longer based on when the failure occurred and instead permit correction within a reasonable time after *discovery* of the failure.

It should be noted that even if self-correction is available under this expanded program, a plan sponsor may prefer to submit a VCP application. Waiver of an applicable excise tax or additional tax, if any, may only be granted through the VCP (or, if the tax cannot be corrected through the VCP, through the Voluntary Closing Agreement Procedure). Plan sponsors deciding to apply through the VPC should be aware of a significant backlog in the IRS's review of submissions and should be prepared for the process to take longer than as has been typical in the past.

Summer Associate, Emily Bernstein, assisted with writing this post.

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