

Lowenstein Sandler's Executive Compensation and Employee Benefits Podcast: Just Compensation

Episode 64

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Megan Monson: Welcome to the latest episode of "Just Compensation." I'm Megan Monson, a partner in Lowenstein Sandler's Executive Compensation, Employment & Employee Benefits Practice Group. I'm joined today by my colleagues, Zach and Taryn, who I'll let introduce themselves.

Taryn Cannataro: Hi, I'm Taryn Cannataro, Counsel in Lowenstein's Executive Compensation, Employment & Employee Benefits Group.

Zachary Bocian: Hi, I'm Zach Bocian, an associate in Lowenstein's Executive Compensation, Employment & Employee Benefits Group.

Megan Monson: Thank you both for being here. Today, we're talking about the IRS's Employee Plans Compliance Resolution System, or EPCRS for short, including the update the IRS released on October 22nd, 2026 in Rev. Proc. 2026-34.

Retirement plan mistakes are common and often inadvertent, whether it's a missed deferral election or a late plan amendment. The EPCRS is how plan sponsors fix many retirement plan issues. Today, we'll cover what the EPCRS is, its three correction programs, how to decide whether the problem that you discover can be self-corrected or whether you must file with the IRS in order to correct it, along with the most common 401(k) plan errors and how to correct them. As always, this is intended to be a high-level discussion and not legal advice, so please consult your advisors about how these rules apply to your specific facts and circumstances. Zach, to start us off, let's start with the big picture. What is the EPCRS?

Zachary Bocian: In the IRS's own words, it's a comprehensive system of correction programs for sponsors of retirement plans that are meant to meet the requirements of code sections 401(a), 403(a), 403(b), 408(k) or 408(p), but that have not met these requirements for a period of

time. In plain terms, it lets retirement plan sponsors fix failures that threaten the plan's tax qualified status. These rules are highly technical and found in the tax code and Rev. Proc. 2026-34.

Megan Monson: Why does it matter so much?

Zachary Bocian: Because technically any plan qualification failure can result in disqualification, which means that the plan loses its tax favored status and the employer, the plan's trust, and participants can all face tax consequences. Disqualification is a harsh result, so sponsors get several chances to fix things. If a sponsor meets the EPCRS's eligibility rules and corrects the failure the way the program requires, the IRS won't treat the plan as disqualified.

Megan Monson: Zach, you mentioned that there are plan failures. Can you talk about how the failures are characterized?

Zachary Bocian: There are four main types of failures. The first is a plan document failure, which is when a written plan provision doesn't comply with the applicable law. A common example of this would be a required amendment that wasn't adopted on time or a change in the law that wasn't applied to the plan.

The next type of failure is called an operational failure. This is where the written plan rules are fine, but they weren't applied correctly in practice. An example of that might be forgetting to take bonuses into account when calculating plan compensation, even though the plan expressly provides that they will be included. Failing to follow the terms of the plan that satisfy ADP and ACP tests also counts as an operational failure.

Another type of failure is a demographic failure, which is a failure to meet the non-discrimination, minimum participation, or coverage rules, meaning the plan is unfairly favoring higher paid employees. An example where this can occur is when a plan's profit-sharing formula results in higher paid workers receiving disproportionately larger allocations than lower paid workers.

Finally, the last type of failure is an employer eligibility failure, which is when an employer that isn't eligible to sponsor a specific type of retirement plan adopts one anyway. For example, a private for-profit company adopting a 403(b) plan, which is available only to public schools and certain other tax-exempt organizations. We most commonly see operational or plan document failures in practice.

Taryn Cannataro: The type of failure matters because it also decides what EPCRS programs you can use.

Megan Monson: On that note, Taryn, can you give us a quick tour of the available correction programs available under the EPCRS?

Taryn Cannataro: There are three correction programs under the EPCRS. The first is the self-correction program, also known as the SCP. Under the SCP, a sponsor with established compliance practices and procedures can, without paying any fee or sanction or having to make any additional IRS filings, correct a failure on its own, as long as the failure isn't egregious. Under SECURE 2.0, most "eligible inadvertent failures can now be self-corrected within a reasonable period of time after discovery, as long as the IRS hasn't found them first."

Second is the Voluntary Correction Program or the VCP. Here, a sponsor files a correction with the IRS at any time before the plan, or plan sponsor, is under IRS examination. The sponsor pays a fee based on the plan's assets and receives a compliance statement from the IRS confirming its approval of the fix. VCP is used for failures that can't be self-corrected, such as failure to adopt a plan document in the first place, or egregious failures. It is also used for non-standard correction methods or simply when the sponsor just wants IRS sign-off on the correction.

Third is the Audit Closing Agreement Program, also known as Audit CAP. This applies when the IRS finds the failure on audit. Under Audit CAP, the sponsor fixes the failure and pays a negotiated sanction that takes into account the tax that would have been owed if the plan were disqualified. It's usually much more expensive than the SCP or VCP.

The order matters in practice. Self-correction is the cheapest and least burdensome to use. VCP gives certainty for a modest fee and Audit CAP is the costly fallback once the IRS is already involved. That is why it pays to find and fix errors early.

Megan Monson: Can all types of failures be self-corrected?

Zachary Bocian: Unfortunately, no. While SECURE 2.0 widened the breadth of failures that can be self-corrected, there are still some types of failures that must go straight to a VCP.

Operational failures are the core use of self-corrections as this is where most inadvertent failures occur. Self-correction of demographic failures has historically been limited, with VCP being used as the usual method of correction, although Rev. Proc. 2026-34 now allows self-correction of demographic failures fixed by a corrective amendment under the non-discrimination regulations. Rev. Proc. 2026-34 also allows self-correction of certain plan document and employer eligibility failures, but some such as a failure to adopt a plan document in the first place still must be corrected through VCP or Audit CAP. Regardless of the type of failure, egregious failures can never be self-corrected and require a VCP or Audit CAP.

Also, as Taryn stated, SCP and VCP generally aren't available once the plan is under IRS examination. In short, SCP is best suited to fixing operational mistakes that are not egregious. VCP can fix almost anything that isn't under exam and Audit CAP is the catchall once the IRS finds the problem at the highest cost.

Megan Monson: Whatever the program, what does the proper fix look like?

Zachary Bocian: Generally, a failure is not corrected unless full correction is made with respect to all participants and beneficiaries and for all taxable years, whether or not the taxable year is closed. The fix should put the plan back where it would have been if the failure had never happened and it should be reasonable and appropriate. The IRS automatically considers any method listed in the Rev. Proc. as reasonable and appropriate. If you use some other method, it should as much as possible look like a method already in the code of regulations.

Taryn Cannataro: There are a few narrow exceptions to the full correction. Reasonable estimates can be used, but a precise calculation isn't possible. For example, if there are old payroll records that aren't available, or the difference between the estimate and the exact calculation would be insignificant, while the cost of precision would be significant. A small corrective distribution owed to a participant of $75 or less also does not have to be made if it would cost more than that to process and deliver, and a sponsor generally does not have to recover a small overpayment or distribute an excess amount of $250 or less.

New in Revenue Procedure 2026-34, a sponsor is generally no longer required to seek repayment of an inadvertent benefit overpayment at all, although the plan can still reduce future payments to correct the amount. In plain English, an inadvertent benefit overpayment is an honest mistake where the plan pays someone more than they were supposed to receive or pay them before they were allowed to receive it.

As long as the plan had reasonable compliance procedures in place, the error isn't egregious and doesn't involve the misuse of plan assets and the overpayment was not made to an owner. Over-payments caused by Section 401(a)(17), the yearly compensation cap, 415, the maximum contribution or benefit cap, or 436, failures, which are restrictions for underfunded pension plans, are excluded from this relief. Sponsors that do seek recoupment must follow the revenue procedures participant, notice and rollover rules. These exceptions are narrow and are geared towards excusing specific small or impractical parts of the correction.

Megan Monson: Taryn, what does a sponsor need to do before it can use SCP?

Taryn Cannataro: Assuming that self-correction is available, the sponsor just needs to have established practices and procedures, whether formal or informal, reasonably designed to promote and facilitate overall compliance. In other words, an honest mistake has to have slipped through an otherwise reasonable system.

The revenue procedure is blunt, that a plan document alone does not constitute evidence of established procedures. The procedures also have to have been in place and routinely followed. The correction also must be made within a reasonable period of time after the failure was identified. The IRS deems corrections reasonable if finished by the later of the last day of the third plan year, after the year the failure occurred or 18 months after the failure was identified.

Once a plan is under IRS examination, it can only be self-corrected to the extent it is an insignificant operational failure, which is determined based on facts and circumstances, or if it's a significant failure that the sponsor has already shown commitment to fixing before the IRS examination. Once you establish that you fit the criteria I mentioned, you can use any correction method that's reasonable and appropriate. It's important to document any self-correction that has been done and the factors that allow you to be comfortable with utilizing that self-correction.

Megan Monson: Zach, then when is VCP the answer?

Zachary Bocian: VCP can fix all four types of failures, as long as the plan or plan sponsor is not under IRS examination. Whether a plan is under IRS examination is determined broadly. It includes being told an examination is coming, and importantly, a determination letter review where the IRS agent points out possible failures. If you want the certainty that a correction fixes an issue, you can utilize VCP.

Megan Monson: Walk us through what the VCP filing that is made to the IRS looks like.

Zachary Bocian: Everything is handled through pay.gov. The sponsor completes and files Form 8950, which is signed under penalties of perjury. The form must include an attachment that describes the failures, how and why they happened, the proposed fix with calculations, how earnings will be calculated, and the changes the sponsor will make so the problem doesn't happen again. The VCP fee range is calculated and paid directly through pay.gov. The IRS then reviews the filing to determine if the failure was reasonably corrected, and since January 1st, 2022, sponsors can no longer file anonymously, but a sponsor's representative can request an anonymous no-fee pre-submission conference through Form 8950 on pay.gov, about that proposed fix that isn't one of the Appendix Safe Harbor's methods.

Megan Monson: What does the sponsor ultimately get from the IRS?

Taryn Cannataro: If the IRS determines that the failure was reasonably corrected under VCP, it will issue a compliance statement listing the failures and the approved corrections. If the IRS asks the sponsor to sign the compliance statement, the sponsor must sign and return it and pay any outstanding fee within 21 calendar days or the submission will be considered closed. The sponsor must also make the fixes within 150 days of the date of the compliance statement. Any extension to that 150-day period must be expressly approved by the IRS. The protection covers only the failures and the years listed. Note, it is not unusual for the IRS to have some questions and back and forth in the submission before issuing a compliance statement.

Megan Monson: On that note, Taryn, I have noticed in recent years that the IRS is a bit more focused on the applications. I can't think of a situation where I haven't gotten some questions related to the submission. Again, just to be mindful of that that's going to be likely a step in the process. What happens if the IRS finds the problem first?

Zachary Bocian: It generally must be corrected via Audit CAP. The Audit CAP sanction is a negotiated amount that generally will not be less than the VCP user fee. The factors used to determine the Audit CAP sanction include what the sponsor did to prevent failures, how far along the fix was when the exam started, and the maximum payment amount, which is roughly the tax the IRS could collect if the plan were disqualified. Under the new IRS rules released on October 22nd, 2026, if the only failure the IRS finds in a determination letter review is that the plan document wasn't updated for a required law change on time that the sponsor didn't voluntarily identify, the sanction is generally 200% of the applicable VCP user fee.

Megan Monson: Zach, what errors does the IRS see the most?

Zachary Bocian: The IRS's own 401(k) fix-it guide lists 12 most common plan failures. They include things like updating the plan document, not following plan terms, using the plan's definition of compensation incorrectly, failed ADP and ACP tests, leaving out eligible employees, deferrals over the Section 402(g) limit, late deposits, loan and hardship errors, and missed top-heavy minimums. This aligns with some of the most common errors we see in practice.

Megan Monson: Are there things that the EPCRS does not cover?

Zachary Bocian: Yes. The EPCRS doesn't cover diversion or misuse of plan assets. It also generally doesn't cover problems where consequences are something other than plan disqualification, such as funding deficiencies, prohibited transactions, and failures to file Form 5500.

It is also important to note that correcting under the EPCRS doesn't change anyone's rights or obligations under ERISA. Separately, the IRS has created a new IRA compliance resolution system in Rev. Proc. 2026-33, effective May 1st, 2027, for certain IRA failures that can't be resolved under the EPCRS.

It's worth noting that the Department of Labor runs its own separate programs, the Voluntary Fiduciary Correction Program or VFCP, under which certain ERISA fiduciary violations may be corrected, and the Delinquent Filer Voluntary Compliance Program for certain 5500 series reporting failures. Those programs are independent of the EPCRS, and the IRS's VCP shouldn't be confused with the DOL's VFCP.

Megan Monson: Thank you both. This has been really helpful. Today we outlined the EPCRS, its three possible correction programs, how to choose what correction program to use, and some common fixes for 401(k) plan errors, including the changes made under the new IRS rules released October 22nd, 2026.

These rules we discussed today are highly technical, as you can imagine, and the details of eligibility and timing really do matter. It's important to engage counsel early and regularly to ensure compliance and avoid unintended footfalls. Our Executive Compensation, Employment & Employee Benefits Group regularly helps plan sponsors evaluate and implement such corrections.

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