

Mistakes Were Made: *Correcting Plan Operational Failures*

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Overview



- Identifying mistakes
- Why you need to correct mistakes
- Fixing mistakes
- Benefit calculation mistakes

Common plan mistakes

- Eligibility issues
- Missed contributions
- Benefit calculations
- Underpayments/overpayments
- Amendment failures

What does your plan say?

- The plan document (statutes or ordinances) dictates who is entitled to benefits and how much those benefits should be.
 - If plan language is unclear, the administrator typically is given discretion to interpret ambiguous provisions.
 - Make sure the plan is interpreted consistently.
 - Consider a plan amendment to ensure consistent application of plan rules.

What does your plan say?

- Some plans will have specific language for how to handle mistakes in benefit calculations or payments.
- Follow the rules of the plan.

Internal Revenue Code

- Governmental retirement plans must be qualified under Code Section 401(a).
 - “Qualified” is short for tax-qualified, meaning money in the plan can be contributed prior to taxation and can grow tax-free.
- There are rules to follow to maintain the qualified status of the plans, including that a plan must be operated in accordance with the terms of the plan document.

Internal Revenue Code

- The term “Qualification Failure” means any failure that adversely affects the qualification of a plan. Rev. Proc. 2021-30, Section 5.01(2).
- The term “Operational Failure” means a Qualification Failure that arises solely from the failure to follow plan provisions. Rev. Proc. 2021-30, Section 5.01(2)(b).

Internal Revenue Code

- If a qualified plan experiences a Qualification Failure that is not corrected, the IRS can “disqualify” the plan, meaning all of the benefits in the plan will become immediately taxable to the participants.



How to Correct

- Employee Plans Compliance Resolution System (EPCRS), Rev. Proc. 2021-30
 - Allows plan sponsors to correct Operational Failures.
 - Resolves any issue the IRS may have with the Plan's tax-qualified status.

How to Correct

- EPCRS General Rules
 - Failures must be fully corrected.
 - Restoration of benefits.
 - “The correction method should restore the plan to the position it would have been in had the failure not occurred, including restoration of current and former participants . . . to the benefits and rights they would have had if the failure had not occurred.”
 - Corrections must be reasonable.
 - Full correction may not be required in certain situations if it is unreasonable or not feasible.

Correction Programs

- Self-Correction Program (SCP)
 - An employer voluntarily corrects significant (within a certain time period) or insignificant failures without seeking the approval of the IRS.
 - The only costs associated are the actual costs of the correction.

Correction Programs

- Voluntary Correction Program (VCP)
 - An employer submits an application to the IRS to receive approval for the proposed correction method for a failure.
 - There is a fee for using the program, which varies based on plan assets.

Correction Programs

- Audit Closing Agreement Program (Audit CAP)
 - The IRS discovers a qualification failure during an audit.
 - To close the audit, the failure must be corrected.
 - The employer will need to pay the actual cost of correction plus a sanction.
 - The sanction imposed will bear a reasonable relationship to the nature, extent, and severity of the failure, taking into account the extent to which correction occurred before audit. It will not be less than the cost of a VCP nor more than the maximum payment amount, which is the amount of tax the IRS would collect if plan benefits became immediately taxable.

Pension Benefit Calculations

- Participant elected a single life annuity but has been being paid the amount of a 50% joint and survivor annuity. Administrator discovers the error after five years of benefit payments.
- Participant was eligible to receive a COLA but did not.
- Participant's benefit was mistakenly calculated based on fewer years of service or lower average compensation than she earned.

Pension Benefit Calculations

- Administrator provided a COLA to someone who was not entitled to it.
- Participant was credited with more years of service or higher average compensation than he earned.
- Participant continued to receive direct deposits after death.

EPCRS Overpayment Correction

- Take reasonable steps to have overpayment returned to the plan (plus earnings). EPCRS, Section 2.05.
 - Single sum, installments, or adjustment of future payments
 - If you cannot collect from the participant, the plan sponsor must repay
 - Additional options if the plan is well-funded

Pension Benefit Calculations

- Administrator sends a pension benefit statement saying participant is entitled to \$X per month. On retirement, the administrator realizes it is \$Y per month, which is substantially less than \$X. What does the participant receive?

Tinnin v. Modot & Patrol Employees' Ret. Sys.

- 647 S.W.3d 26, 34 (Mo. Ct. App. 2022)
 - MPERS sent statement that current benefit would be \$2,747.59 and maximum amount ex-spouse could receive was estimated to be \$1,373.79 per month.
 - Accountant determined that the present value of the marital portion was \$541,527.68.
 - Separation agreement provided that upon ex-husband's retirement, ex-wife would receive 40.77% of MPERS benefits that accrued during the marriage.

Tinnin v. Modot & Patrol Employees' Ret. Sys.

- After divorce, MPERs sent letter stating:
 - The monthly retirement benefit accrued from August 1, 1986 (date of employment) to December 30, 2008 (date of divorce), was \$6,994.01. The [division of benefits order] indicates Ms. Judy Tinnin was awarded 40.77% of the benefit; therefore, she will receive a monthly benefit in the amount of \$2,831.07 at the time [ex-husband] retires.
- Overstated benefit by using wrong final average pay.

Tinnin v. Modot & Patrol Employees' Ret. Sys.

- For nine years, ex-wife repeatedly met with financial advisor relying on letter from MPERs and planning on receiving a benefit of \$2,831.07.
- In July 2018, MPERs sent a letter that ex-husband was retiring and ex-wife would begin receiving a monthly payment of \$1,353.88.
- Ex-wife asked for review of benefit amount.
- MPERs found \$1,353.88 was correct.

Section 104.200

- Should any error in any records result in any member's [sic] or beneficiary's [sic] receiving more or less than he would have been entitled to receive had the records been correct, **the board shall correct such error, and, as far as practicable, make future payments in such a manner that the actuarial equivalent of the benefit to which such member or beneficiary was entitled shall be paid**, and to this end may recover any overpayments. In all cases in which such error has been made, no such error shall be corrected unless the system discovers or is notified of such error within ten years after the initial date of error.

Tinnin v. MPERs

- Trial court found that “as far as practicable” permitted only reasonable corrections.
- Appellate court disagreed.
 - “The plain language of the correction statutes resolves the current dispute about their meaning. The correction statutes provide that MPERS's ‘board shall correct such error,’ referring to any calculation error that results in a person receiving a payment that is more or less than what should have been paid. ‘The word ‘shall’ generally prescribes a mandatory duty.’”

Questions?

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