

# Retirement Plan Overpayment Corrections Continue to Evolve

by Kenneth F. Ginder on November 4, 2024

For over twenty years, the IRS has provided guidance on correcting overpayments from retirement plans through its correction program, the Employee Plans Compliance Resolution System, currently set forth in Revenue Procedure 2021-30 (“EPCRS”).<sup>1</sup> In 2022, new statutory provisions were passed addressing overpayments, and on October 15, 2024, in response to those new provisions, the IRS published additional guidance in the form of Notice 2024-77 (the “Notice”). This post provides relevant context, highlights, and recommendations concerning the Notice.

## Statutory Rules

In 2022, the SECURE 2.0 Act added Section 414(aa) to the Internal Revenue Code of 1986, as amended (the “Code”). Code Section 414(aa) applies to defined benefit plans, defined contribution plans, including 401(k) and 403(b) plans, and governmental 457(b) plans and provides four basic rules concerning overpayments:

- (1) As a general rule, a plan will not fail to be treated as qualified “merely because” (i) it fails to obtain payment from any participant, beneficiary, employer, plan sponsor, fiduciary, or other party on account of any “inadvertent benefit overpayment” made by the plan, or (ii) the plan sponsor amends the plan to increase past or decrease future benefit payments to affected participants and beneficiaries to adjust for prior inadvertent benefit overpayments.
- (2) A plan will not fail to be qualified “merely because” after discovering a benefit overpayment, the plan reduces future benefit payments to the correct amount or seeks recovery from the person responsible for the overpayment.
- (3) Employers are not relieved from (i) any minimum funding requirements under Code Sections 412 or 430 or (ii) preventing or restoring impermissible forfeitures under Code Section 411.
- (4) Notwithstanding any rules in Section 414(aa) to the contrary, a plan must comply with any limitation imposed by Code Sections 401(a)(17) (relating to compensation) and 415 (relating to benefits and contributions).

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<sup>1</sup> See, for example, Revenue Procedure 2003-44, Appendix B, §2.04 Return of Overpayment Correction Method (“The employer takes reasonable steps to have the Overpayment (with appropriate interest) returned by the recipient”); see also our 2015 blog post, [IRS Clarifies the Correction of Overpayments under EPCRS | Benefits Law Update](#).

In addition to Section 414(aa), the SECURE 2.0 Act added Section 402(c)(12) to the Code, which states:

“In the case of an inadvertent benefit overpayment from a plan . . . that is transferred to an eligible retirement plan . . .

(A) the portion of such overpayment with respect to which recoupment is not sought on behalf of the plan shall be treated as having been paid in an eligible rollover distribution if the payment would have been an eligible rollover distribution but for being an overpayment, and

(B) the portion of such overpayment with respect to which recoupment is sought on behalf of the plan shall be permitted to be returned to such plan and in such case shall be treated as an eligible rollover distribution transferred to such plan by the participant or beneficiary who received such overpayment (and the plans making and receiving such transfer shall be treated as permitting such transfer).”

## IRS Guidance

EPCRS outlines several correction methods for overpayments. The Notice, which is effective October 15, 2024, provides interim guidance on the impact of Code Sections 414(aa) and 402(c)(12) on EPCRS.

## Highlights and Recommendations

The following items highlight important aspects and recommendations concerning the Notice:

(1) *The Notice and EPCRS.* The Notice must be read in conjunction with EPCRS. You are missing important guidance if you read the current version of EPCRS without the Notice. For example, the Notice states explicitly that the definition of “overpayment” in EPCRS is modified, certain notification rules in EPCRS no longer apply, and any requirement of a corrective payment to the plan under EPCRS Section 6.06 no longer applies. Print or save a copy of the Notice and keep it with your copy of EPCRS.

(2) *Definition of Inadvertent Benefit Overpayment.* “Inadvertent benefit overpayment” is not defined in Code Sections 414(aa) and 402(c). The Notice defines it as an eligible inadvertent failure due to a payment from a plan that exceeds the amount payable under the plan’s terms or a limitation imposed by the Code or regulations. The Notice also provides that a payment made before a distribution is permitted under the plan’s terms or the Code is an inadvertent benefit overpayment.

There are two important issues to consider when applying the definition. First, the overpayment must be an “eligible inadvertent failure.” As defined in Section 305 of the SECURE 2.0 Act, an eligible inadvertent failure means a failure that (i) is not egregious, (ii) does not relate to the

diversion or misuse of plan assets, (iii) is not directly or indirectly related to an abusive tax avoidance transaction, and (iv) occurs despite the existence of “established practices and procedures.” While the first three components of the definition are relatively straightforward, the

fourth requirement—whether established practices and procedures exist—can be trickier, and we recommend our 2023 post on that topic: [Establishing Practices and Procedures to Support Self-Correction of Operational Failures | Benefits Law Update](#).

Second, an inadvertent benefit overpayment does not include a payment to a “disqualified person” or an “owner-employee” as defined in Code Sections 4975(e)(2) and 401(c), respectively. Many individuals can fall under these definitions (for example, fiduciaries, employers, certain employees, shareholders, and family members). It is vital to be aware that the rules under Code Sections 414(aa) and 402(c)(12) allowing a plan to not seek the return of an overpayment and providing favorable rollover treatment would not apply to them.

(3) *Required Repayment.* Any provision within Section 6.06 of EPCRS requiring repayment to the plan as part of a correction no longer applies. There are, however, important exceptions. Funding failures under Code Section 436 and failures to observe limits imposed by Section 401(a)(17) and 415 may require corrective payments. In addition, other failures may occur as part of an overpayment, and those could require corrective payments. For example, if a participant received an inadvertent benefit overpayment due to an incorrect profit-sharing allocation and, as a result, another participant received a benefit underpayment, the IRS would consider this to be two separate failures, and the underpayment will likely require a corrective contribution.

(4) *Optional Repayment.* The Notice clarifies that the existing rule in EPCRS that allows repayment from overpayment recipients is still permitted but not required. However, it is important to be aware that in 2022, Congress also added Section 206(h) to the Employee Retirement Income Security Act of 1974, as amended (“ERISA”), and the Notice does not address Section 206(h). ERISA Section 206(h) provides that if a plan fiduciary seeks recoupment, the fiduciary must comply with several requirements. For example, no interest may be sought, and, in the case of certain annuity payments, the amount that can be recouped each year is limited.

(5) *Rollovers.* An inadvertent benefit overpayment that is rolled over to an eligible retirement plan will be treated as an eligible rollover distribution if (i) repayment is not sought, and (ii) the payment would have been an eligible rollover distribution “but for” being an overpayment.

There are several significant consequences to this rule. First, if repayment of the overpayment is not sought, it can remain in the plan or IRA into which it was rolled over without adverse tax consequences. Second, if repayment is sought and not received, the payment will not be treated as an eligible rollover distribution, and the plan sponsor must notify the individual that the unreturned portion of the overpayment is not eligible for the tax-free rollover. Third, if the payment violated some other rule (e.g., exceeded the Code Section 401(a)(17) or 415 limits), it would not be an eligible rollover distribution.

(6) *Transfers Between Plans.* If an inadvertent benefit payment is rolled over from an originating plan to an eligible retirement plan, any amount sought and returned to the originating plan is



treated as an eligible rollover distribution from the originating plan and as an eligible rollover distribution transferred back to the originating plan.

Notably, the tax treatment described above will apply regardless of the terms of either plan. In other words, neither plan must be amended for these corrective transfers to be treated as eligible rollover distributions.

## **What is Next?**

Overpayments have been a part of plan corrections guidance for many years. The Notice is the latest chapter in the development of overpayment corrections. Importantly, the Notice states that it is “interim” guidance and not intended as comprehensive guidance to Code Sections 414(aa) and 401(c)(12). Accordingly, we anticipate that the rules will continue evolving and may become more complicated.

If you have questions about overpayments and your retirement plan, please contact [kginder@verrill-law.com](mailto:kginder@verrill-law.com) or a member of Verrill’s Employee Benefits & Executive Compensation Group.



### **Kenneth F. Ginder**

Partner

T (207) 253 4912

[email](#)