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401(k) Plan Changes In SECURE Act May Necessitate System Changes

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The Setting Every Community Up for Retirement Enhancement Act of 2019 (the SECURE Act) was signed into law on December 20, 2019, as part of the Further Consolidated Appropriations Act, 2020 (CAA).[1] While the law was designed to encourage small employers to adopt or expand access to qualified retirement plans, the tools provided for such expansion will require a number of system changes to capture the information needed to administer the new provisions and to accommodate new provisions for distributions for children born to or adopted by a plan participant and the new repayment option for such distributions.

DESIGN CHANGES AND QUALIFICATION REQUIREMENTS FOR 401(k) AND OTHER DEFINED CONTRIBUTION PLANS

Required Minimum Distributions

Required minimum distributions for all qualified plans have changed to require commencement in the calendar year in which the employee turns age 72 or when they retire, instead of age 70½ or at retirement.[2] All qualified retirement plans will need to be amended for this change. The change to the age for commencing required minimum distributions is effective for distributions required to be made after December 31, 2019, with respect to individuals who attach the age of 70½ after December 31, 2019.[3] On January 24, 2020, the Internal Revenue Service (IRS) issued guidance to financial institutions on reporting required minimum distributions following the CAA.[4] This is a change to a qualification requirement in §401(a).

Plan Establishment

The IRS has followed Reg. §1.401(k)-1(a)(3)(iii)(A)'s requirement as to the timing of adding a cash or deferral election to a plan by requiring that the plan be amended to include the cash or deferral arrangement be adopted before it becomes effective to permit payroll distributions of funds from employees' paychecks. The SECURE Act amended §401(b) to permit adoption of a stock bonus, pension, profit sharing, or annuity plan after the close of the taxable year. This is as long as the plan in question is adopted before the due date for filing the return of the employer for the taxable year and permits the plan

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[1] Pub. L. No. 116-94 (H.R. 1865).

[2] §401(a)(9)(C)(i), added by CAA, Division O, §114(a). Unless otherwise indicated, all section references herein are to provisions of the Internal Revenue Code of 1986 (the "Code"), as amended, and the regulations promulgated thereunder.

[3] CAA, Division O, §114(d) amending §401(a)(9) and §408(b).

[4] Notice 2020-6.

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adoption be retroactive to the last day of the taxable year.[5]

The SECURE Act amendment to §401(b) only addresses the adoption of a profit sharing, stock bonus, pension, or annuity plan. It does not mention the adoption of a cash or deferred arrangement under §401(k) and the §401(k) regulations are final and have been enforced to require adoption of a plan with a §401(k) cash or deferred arrangement before any deferrals under the §401(k) plan can be started. The IRS still needs to issue further clarification indicating if the new §401(b) provision overrules the long-standing Treasury regulation on when a cash or deferred arrangement was added to create a §401(k) plan must be adopted. Thus employers should remember the regulation's requirement until guidance clarifies either which supersedes the other or how the two should be construed together.

Furthermore, one should note that this provision provides an extension for adoption of a stock bonus, profit sharing, or annuity plan, but it does not provide any extension for a remedial amendment or a discretionary amendment, and it does not mention adoption of a cash or deferred arrangement.[6] This change is effective for the specified types of plans adopted for taxable plan years beginning after December 31, 2019.[7]

Expansion of 401(k) Plan Deferral Opportunities to Long Service Part-Time Employees

In an effort to expand the availability of §401(k) plans to long-term employees who work part time, the SECURE Act added a new provision to §401(k) that permits employees who for three consecutive years work more than 500 hours in each of those three years to participate and to accrue your vesting service for each year in which they work 500 hours of service or more.[8] These long-term part-time employees are not required to receive an top-heavy contribution or top-heavy minimum vesting, nor are they required to be part of any §401(k) safe harbor contribution whether it be matching or an qualified non-elective contribution.

While many larger employers utilize immediate eligibility for new hires negating the need for this special provision, some employers still require employees to complete a minimum period of service before they can enter the plan. Most systems do not track individuals who retain 500 hours of service in the current year and for the previous two consecutive years because until now such information was not necessary. Nor do systems currently credit a year of service for vesting based on two different hours of service standards. Employers who do not offer immediate eligibility and entry into the §401(k) plan will need to consider how they will keep records of whether each individual employee has attained 500 hours in three consecutive plan years to be eligible to enter the §401(k) plan under this provision. The new provision also does not address what happens if an individual who satisfied the three consecutive years of 500 hours of service requirement fails to continue to work at least 500 of service in subsequent years. Such individuals who are permitted to participate under a relaxed hours worked standard are tested separately for purposes of the ADP testing.[9]

Employers permitting immediate eligibility have tested the individuals permitted to enter the plan early before they complete the age and service requirements under §410(a)(1) separately under Reg. §1.401(k)-2(a)(1)(iii)(A). Since these individuals fall within such separate testing category, it will be interesting to see how the existing separate testing will work when part of the group will be bound by this new set of separate obligations, but an employer offering immediate eligibility to all employees will have some employees in the group that does not meet the §410(a)(1) age and service requirements who will be protected by §401(k)(15) and some will not have such protections.

The addition of this requirement is applicable to plan years beginning on or after December 31, 2020.[10] However, for purposes of calculating whether an employee has completed 500 hours or more in three consecutive plan years, the 12-month periods beginning before January 1, 2021, shall not be taken into account. This means that employers have until the end of calendar year 2020 to make system changes to start capturing when each employee works 500 or more hours in a 12-consecutive-month period and to retain records of in which year such limit was achieved. Guidance will be necessary to determine if the plan sponsor can determine which 12-month period will be used for this record or if the statutory requirement of three consecutive 12-month periods means any 12-month period that may vary by individual. This would be an administrative nightmare and require systems to maintain hours worked by month to accumulate toward calculation of the 500 hours in a 12-month period. Since records are only re-

[5] CAA, Division O, §201.

[6] CAA, Division O, §201.

[7] CAA, Division O, §201(b).

[8] §401(k)(15).

[9] CAA, Division O, §112.

[10] CAA, Division O, §112.

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quired on or after January 1, 2021, with respect to the hours worked to trigger an individual's enrollment under this provision, the three consecutive 12-month period requirement means that this effectively will not start enrollments under this provision until January 1, 2024.

Whether this new tier of eligibility means that employers need to segregate this group from the group that is permitted to enter the plan prior to meeting age 21 and completing one year of service, so that there are two groups who must be tested separately, who are below the one year of service, will need to be determined. This newly eligible group will also need to be tracked separately for vesting since they will have a 500 hours of service requirement for vesting that will need to be tracked separately since other employees will have a 1,000 hour of service requirement. Will this drive down what it takes to have a year of service for vesting for everyone? How will this interact with persons who take a Family and Medical Leave Act absence who receive service credit to avoid a one-year break in service under §410 and §411? How will it interact with persons on a Uniformed Services Employment and Reemployment Rights Act leave? This provision, while intended to broaden coverage, raises many questions regarding how to coordinate it with existing legal requirements.

Time will tell if this change will drive more employers toward immediate eligibility and lower or no employer matching contributions to avoid tracking the vesting on matching using different requirements, or just lower the hours for a year of service for all employees.

New Safe Harbor 401(k) Plan Requirements

Plan sponsors with safe harbor §401(k) plans received some relief as they used the qualified nonelective contribution at 3% even if they did not provide a notice of the safe harbor nature of the plan. The safeharbor notice is still required for plans using the safeharbor matching contribution formula. Furthermore, plans that desire to adopt the safe harbor qualified nonelective contribution method and failed to do so prior to the 30th day before the end of the plan year are also required to send the safe harbor notice. Such plan may still adopt a 4% qualified nonelective contribution as a safe harbor plan, provided that the amendment is adopted no later than the last day by which any excess contribution is required to be refunded for that plan year.[11] Safe harbor plans still only qualify as a safe harbor plan if all plans within the control group also meet the requirement to be a safe harbor plan under §401(k)(12)(G).[12]

Increasing Automatic Contribution Maximum from 10% to 15% for QACAs

The §401(k) safe harbor known as the Qualified Automatic Contribution Arrangement[13] (QACA) was also amended to adopt the same change with respect to permitting the use of the qualified nonelective contribution without requiring a notice to the employees in advance of the plan year. Although the QACA still requires advance notice to employees when the matching contribution is used. The main change was to increase the limit on the maximum limit on the automatic contributions from 10% to 15%.[14] While this increases the maximum limit, it will only require an amendment if the employer decides it wants to increase its maximum limit on its QACA automatic contribution formula.

This change did not impact the Eligible Automatic Contribution Arrangements under §414(w) (EACA) which applies to both §401(k) and §403(b) plans. EACAs do not provide a safe harbor from the §401(k) nondiscrimination testing or require any matching contribution. Although these EACA arrangements do provide a mechanism to automatically enroll employees in a retirement plan or §403(b) arrangement and commence their saving toward retirement. EACAs do not have a minimum automatic deferral rate or a maximum automatic contribution rate; thus, there was no need for this QACA change to apply to the EACAs.

Change in Calculation of Annual Addition Limit for Defined Contribution Plans

Qualified defined contribution plans are required to limit the additions to each participant's account to no more than the annually adjusted dollar limit or 100% of compensation.[15] The calculation of the 100% of compensation prong of the annual addition limit was amended to require plans to consider ''difficulty of care payments'' as part of the participant's compensation or earned income so such amount must be considered in calculating such individual's limit on con-

[11] §401(k)(12)(F)(iii).

[12] CAA, Division O, §103.

[13] §401(k)(13).

[14] CAA, Division O, §102.

[15] §415(c)(1).

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tributions allocated to the individual's account.[16] How an employer will receive such information and incorporate it into its annual calculations is not addressed, nor does the statute explain what documentation an employer must retain as proof that the increased annual addition limit is correct.

SELECT DEFINED BENEFIT CHANGES IN QUALIFICATION REQUIREMENTS

Pension Plan Changes on Phased Retirement Distribution Commencement

There were several changes impacting certain defined benefit pension plans. One of the changes impacts all pension plans as it changes the earliest date at which a qualified plan can commence in-service distributions to an individual who is still employed from age 62 to 59½ years.[17] This is a change to facilitate phased retirement; however, regulations defining how phased retirement have yet to be issued since §401(a)(36) was added in the Pension Protection Act of 2006.[18] This change is effective for plan years beginning after December 31, 2019.[19]

Required Minimum Distribution Age Change

The change in the minimum required distribution mandated commencement age discussed above also applies as a qualification requirement to a defined benefit pension plan.

Funding Changes for Certain Community Newspapers

There are pension funding changes for certain community newspapers meeting specified requirements that will ease the funding pressures by replacing the yield curve with an 8% rate and by extending certain amortization periods from seven years to 30 years.[20] These changes are beyond the scope of this article.

Frozen Pension Plan Nondiscrimination Relief

Defined benefit plans with frozen classes of participants that were closed to new participants by April 5, 2017, and which satisfied §401(a)(4) when frozen may be protected from being disqualified by failing to meet minimum coverage requirements if the conditions in the statutory provisions are satisfied. Protection extends to plans which may be spun off. Given the detailed requirements for each of the ways in which a plan may be eligible for this relief, one should carefully review each plan's facts to the statutory requirements. This statutory relief is a welcome change for waiting for the Internal Revenue Service to re-extend relief provided in prior year guidance.[21]

LEGISLATIVE DEADLINE FOR REQUIRED PLAN AMENDMENTS FOR MANDATED SECURE ACT CHANGES

Compliance with the SECURE Act's changes in plan qualification requirements and relief from the anti-cut-back rule is available for an amendment to a retirement plan or annuity contract if it is adopted on or before the last day of the first plan year beginning on or after January 1, 2022 (or 2024 for governmental plans that adopted pre-ERISA[22] money purchase plans).[23] It is important to distinguish between which changes are changes to a qualification requirement and which are merely the addition of permissible changes. It will be important to watch for guidance to see if this continues to be the deadline for amendment and to watch the effective dates separately provided for each of the changes.

DESIGN CHANGES AND CHANGES IN TAXATION OF CERTAIN DISTRIBUTIONS

Participant Loan Change

The SECURE Act prohibited participants from obtaining loans from retirement plans using either a credit or debit card to access the retirement account effective as of December 20, 2019.[24] Hopefully all record keepers for plan sponsors of retirement plans which used debit or credit cards to access a participants account for a loan immediately turned off that feature on the date the law was signed on December 20, 2019. Such a change in a plan's provisions may also require plan administrator to issue a summary of material modifications to the summary plan descrip-

[16] §415(c)(8).

[17] CAA, Division M, §104.

[18] Pub. L. No. 109-280, §905(b).

[19] CAA, Division M, §104.

[20] CAA, Division O, §115.

[21] §401(o)(1).

[22] ERISA refers to the Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829 (Sept. 2, 1974).

[23] CAA, Division O, §601.

[24] CAA, Division O, §108.

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tion for the plan to notify the participants of the change if the summary plan description included information regarding the credit or debit card loan access provision.[25] This would also be an amendment to the plan in the form of changing a right or feature of the plan, and require the participant to be notified of the change in their rights under the plan as required by ERISA. This was an amendment to §72(p)(2)(D). While this is not technically a change in a requirement for a plan's qualification, it is a necessary change to avoid the income inclusion for all the participants who might take a participant loan after the effective date.

Distribution for Birth or Adoption of Child

Section 72(t) was amended to eliminate the additional 10% income tax penalty on a distribution from the right retirement plan in the event of a child's birth or adoption.[26] This new qualified birth or adoption distribution may be distributed in an amount of up to $5,000 in the aggregate for one child provided it is for distributed within one year of the child's birth or adoption being finalized. The $5,000 limit is a cap for all retirement plans maintained within the same controlled group of companies under §414(b), §414(c), §414(m), or §414(o). This provision will require coordination between plans maintained within the same control group and provides an incentive for having all plans in the same control group utilize the same record keeper.

The change to §72(f) further permits the participant to repay the qualified birth or adoption distribution to the plan in one or more payments which in total do not exceed the amount distributed. The limitation of repayments will require coordination between plans within the same control group. It is important to remember that the amendment added by the SECURE Act is a change to eliminate the 10% additional tax penalty on an early distribution and it did not change the permitted distributions out of funds contributed as elective deferrals under §401(k)(2)(B) as a hardship distribution under Reg. §1.401(k)-1(d). However the amendment to §72(t)(2)(H)(vi) provides that such a qualified birth or adoption distributions are deemed to satisfy the distribution requirements under §401(k)(2)(B)(i), §403(b)(7)(A)(ii), §403(b)(11), and §457(d)(1)(A) per §72(t)(2)(H)(vi). Thus, the qualified birth or adoption distribution is treated as permitted even though it is not mentioned in §401(k), §403(b)(7), §403(b)(1) or in an §457(b) plan.[27] Such new qualified birth or adoption distribution rules apply to distributions after December 31, 2019.[28] However, while the qualified birth or adoption distribution and repayment is effective for such distributions after December 31, 2019, the plan document will need to provide for such distribution and the rules regarding repayment of such a distribution.

The repayment provision will require new system changes because there is no current requirement of repayment in a minimum of one or more payments with no interest involved. Participant loan repayments require level amortization and interest. However, this distribution appears to exclude any interest or recognition of the earnings lost on the withdrawal. Systems will need to be set up to provide for repayment of the qualified birth or adoption distributions both in recordkeeping systems and in employer payroll systems as these must be accounted for differently than employee deferral contributions or employee participant loan repayments. A participant who has both loans and a qualified birth or adoption distribution available may prefer to take a loan, if available, and repay it via the level amortization which permits amortization of the repayment over time and restoration of the principal amount with earnings to the retirement account.

If a participant takes a qualified birth or adoption distribution, such participant's deferrals to a qualified retirement plan for that year may not exceed a qualified birth or adoption distribution which is made from that plan to the individual. While recent tax law changes eliminated the cessation of a participant's elective deferrals when they took a hardship distribution, this new distribution includes a restriction on contributions made by an individual taking a qualified birth or adoption distribution. The contribution cessation, contribution limit, and repayment will require programming to ensure that the limitation is applied to the payroll deductions and contributions to the plan.

Qualified Disaster Distribution

While this change is not technically within the portion of the CAA comprising the SECURE Act, it is within the CAA. Section 72(t) was made inapplicable to "qualified disaster distributions."[29] Such qualified disaster distributions are in amounts of up to the total which is the difference between $100,000 less the aggregate amounts treated as qualified disaster distributions received by such individual for all prior taxable

[25] ERISA §104(b).

[26] CAA, Division O, §113.

[27] §72(t)(2)(H)(vi)(IV).

[28] CAA, Division O, §113(b).

[29] CAA, Division Q, Subtitle D, Title II, §202.

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years. This limit is applied to all plans from any member of the controlled group of the employer.

The individual may repay the qualified disaster distribution within three years that begins on the date after the distribution was received in one or more payments. The individual may elect to include the amount in income ratably over a three year period. The qualified disaster distribution is treated as meeting the plan's requirements for purposes of §401(k)(2)(B)(i), §403(b)(7)(A)(ii), §403(b)(11), and §457(d)(1)(A), but did not amend any of those sections.[30]

403(b) Plans Not Subject To Long Service Part-Time Rule

The provision under the SECURE act for extending the opportunity to contribute to §401k plans for long-term part-time employees did not apply to §403(b) plans as §403(b) plans are still subject to the uniform participation rule that if an individual can contribute $200 they are eligible to contribute to a §403(b) plan[31] and there was no reason to place, what would be a higher requirement for participation, on a §403(b) plan.

Section 403(b)(7) and §403(b)(9) were amended like §401(a) to permit distributions of lifetime income investments and annuity contracts, when the annuity issuer is no longer offered under the plan.

Automatic Extensions for Taxpayers in Federally Declared Disaster Areas

The IRS has issued relief to taxpayers impacted by certain federally declared disasters for many years under §7508A. The CAA amended §7508A to provide statutory extensions for qualified taxpayers, that provide a mandatory extension of 60 days beginning on the earliest incident date specified in the declaration and ending on the date which is 60 days after the latest incident date which was one of the specified disasters. For pensions, the extension shall apply with respect to (1) making contributions to a qualified retirement plan under §219(f)(3) (IRAs), §404(a)(6) (qualified retirement plans), §404(h)(1)(B) (SEP), or §404(m)(2) (SIMPLE retirement accounts); (2) for making distributions from individual retirement accounts under §408(d)(4); and (3) for certain other purposes not related to qualified retirement plans.[32]

Increase in Penalty for Failure to File Form 5500

The SECURE Act also increased penalties related to failure to file certain retirement plan returns.[33] However, since the article is focused only on changes impacting §401(k) plans, the article only raises this as another item to watch. The scope of the article is limited to certain changes to §401(k) plans and a few other changes for single employer plans. The article also does not address the changes related to IRAs, stretch IRAs, defined benefit plans, the qualified lifetime annuity distribution provisions, the qualified lifetime income annuity changes to the I.R.C. or ERISA, the multiple employer plan changes, or the pooled plan changes. The article does not address the repeal of the Cadillac tax under §4980I, but the author is grateful for that provision. The article also does not address the changes to §403(b) plans in general or the details of the new protections for frozen defined benefit plans meeting certain requirements or the funding relief for community newspapers or any other changes under the SECURE Act to reporting and disclosure penalties.

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[30] Section 72(t) made inapplicable to qualified disaster distributions by CAA, Division Q, Subtitle D, Title II, §202.

[31] §403(b)(12)(A)(ii).

[32] CAA, Division Q, §205.

[33] *See generally* CAA, Division O, §403.

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