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Employee Benefits Corner

Plan Sponsors Face Challenges Implementing the SECURE Act

By Elizabeth Thomas Dold and David N. Levine

Late last year, Congress passed the Further Consolidated Appropriations Act of 2020, which included a number of pension provisions to facilitate retirement savings, many of which with an effective date of January 1, 2020. Since that time, plan sponsors and their service providers have been working hard to understand the scope of the changes and how best to implement them.

This column highlights just some of the Internal Revenue Code changes that are problematic and that will need the careful hand of Treasury and the Internal Revenue Service (IRS) to provide guidance, along with generous transition guidance for plan sponsors maintaining tax-qualified plans.

Pooled Employer Plans

Coming in the near future, there will be an opportunity for unrelated employers to enter into a new arrangement, called a pooled employer plan (PEP), which has some very favorable ERISA protections. However, on the tax side, work is needed to navigate the existing multiple employer plan rules under Code Sec. 414(c), as these rules typically bring in tracking and counting service for all employers with the PEP for eligibility and vesting service, and typically restrict a distribution on termination of employment if the worker gets reemployed with another employer in the same PEP. They also bring in an aggregate Code Sec. 415 limit on contributions that can be difficult to understand why an unrelated employer plan contribution may be restricted due to plan contributions made by an unrelated employer. And lastly, there is the historic "one bad apple" rule that is provided some relief in the SECURE Act but will need to work with IRS and Treasury regarding the steps needed to be taken to ensure that a single plan in the PEP does not impact the tax qualified status of the remainder of the plans. The current proposed regulations were a step in the right direction, but they are not without their burdens.

Updated 402(f) Rollover Notice

Plan sponsors and service providers are eager to receive the updated sample notice from the IRS with the SECURE Act changes. This is important because the old

Notice, Notice 2018-74, cannot technically be relied upon as the SECURE Act provisions are now effective. And failure to provide a 402(f) notice can trigger a $100 per notice penalty.

The Notice will need to reflect the change in the age 70-½ to age 72 for the required beginning date for minimum required distributions for individuals born after July 1, 1949. The Notice will also need to reflect the exception to the Code Sec. 72(t) (10% additional tax for early withdrawals) (and that the amount is not eligible for rollover) for certain child birth and adoptions. It may also address some of the details regarding the post-death changes to defined contribution plans and IRAs (so called elimination of the stretch IRA).

In-Service Distribution for Child Birth and Adoptions

Plan sponsors (other than sponsors of defined benefit plans) may be interested in offering a special in-service distribution right of up to $5,000 for a child adoption or birth, to help new parents with the costs associated with raising a child. But prior to implementation, there are a number of issues that need to be addressed to ensure that the plan's tax qualified status is not put in jeopardy.

The SECURE Act provided a number of changes to qualified plans, but full and proper implementation will require IRS and Treasury guidance, which we all eagerly await.

First, it appears the intent is to permit $5,000 for each child (so twins get $10,000), but this should be confirmed in addition to what documentation will be required prior to making the distribution. Will a self-certification alone be sufficient, similar to how hardship expenses through a streamed-line process is permitted (with the participant retaining documentation of the birth or the final adoption paperwork), or will a birth certificate or final adoption paperwork be required to be maintained by the employer?

Second, it is presumed that this special in-service right is an optional plan design that requires a plan amendment, which should be confirmed by the IRS, along with the ability to add restrictions on such payments (*e.g.*, only from fully vested accounts, or from certain sources). And if elected, it appears that an unlimited right to repay the distribution back to the plan must be preserved without a time restriction (unlike other repayment rights that generally have a three year period to facilitate a tax refund for the returned funds). This adds added complexity to the proper sources of these funds, and the rules for subsequent distribution. And once a decision is made to offer the withdrawal right, can it be later eliminated or is there an anti-cutback concern with eliminating the new in-service distribution?

Third, for plans that do not want to offer this special in-service distribution right, questions arise whether they need a plan amendment to expressly exclude from rollover contributions such child/adoption repayments. Ideally, confirmation that all is required for an otherwise eligible distribution from the plan is to indicate on Form 1099-R if the participant is not yet age 59-½ and no other code applies that Code 1 in box 7 is appropriate. This will permit a participant to file Form 5329 with their income tax return to claim an exemption for the Code Sec. 72(t) tax. Moreover, guidance should clarify that the plan sponsor has no other duty even if the participant notifies the plan sponsor that the distribution will be used for such an event—so no reporting or withholding issues for treating the payment as eligible for rollover, withholding 20% federal income taxes, and providing a 402(f) notice.

Minimum Required Distributions—Lifetime Payments

For lifetime payments, the required beginning date was changed from April 1 of the calendar year following the year the participant turns age 70-½ (or retires, if later and not a 5% owner) to the later of April 1 of the calendar year following the year the participant turns age 72 (or retires, if later and not a 5% owner) for participants who turn 70-½ after December 31, 2019. Notably, there was no change to the actuarial adjustment that is required post age 70-½ for defined benefit plans.

This results in a number of complexities for plan sponsor and service providers, which maintaining multiple sets of rules for MRDs (some with age 70-½ and others with age 72, based on their birth date) puts added pressure of obtaining the correct birthday and proper compliance.

It also may well lead to participant confusion, resulting in either a failure to take an MRD or take a distribution thinking it is an MRD when, in fact, it is not. These errors raise plan qualification concerns, reporting and withholding concerns (as MRD payments are not eligible for rollover and not subject to mandatory 20% withholding), as well as 50% excise tax concerns for the participant who fails to take their MRDs timely. And corrections for these errors may be also challenging with the varying reporting and withholding rules, and the limited ability to restore plan payments (*e.g.*, Rev. Proc. 2016-47 for waiving the 60-day period).

Plans with a required beginning date based only on reaching age 70-½ have the added level of complexity of whether the required beginning date is an in-service distribution that is a protected benefit (and therefore must be preserved). Presumably, the broad anti-cutback relief that was contained in the SECURE Act (or otherwise IRS transition relief) will permit simply replacing age 70-½ with age 72 without cutback concerns for participants who were born after July 1, 1949.

Minimum Required Distributions—Post-Death Payments

For post-death distributions, plan sponsors of defined contribution plans will have a number of changes to consider as the SECURE Act made a number of changes that generally curtail the period that beneficiaries can maintain the favorable tax-deferral treatment (10 years, with limited exceptions for lifetime payments for certain individuals/trusts) under both a defined contribution plan and an IRA. This is the so-called elimination of the stretch IRA.

There are a large number of open issues, and extensive IRS regulations will need to be re-written to accommodate the new rules. Just to name a few: (1) is the "at least as rapidly rule" eliminated for all designated beneficiaries (which appears to be the intent), (2) do the long-standing look-through trust rules continue to play a role in determining who is a designated beneficiary, (3) what law do I use to define the term "child" and "age of majority," (4) what defaults apply in the event the plan is silent, (5) can an eligible designated beneficiary elect either the 10 year rule or the life expectancy rule (or can the plan limit the available options), (6) if the plan provides for distribution faster than these rules, how is the MRD amount (which is very important for rollover purposes), and (7) how do I know if the plan is covered by a "collective bargaining agreement" (which is not defined) and therefore eligible for a delayed effective date?

Although the IRS took an important first step to provide relief for IRA providers in Notice 2020-6, they signaled the need for additional relief therein, and although relief and guidance may be difficult until the final regulations are issued, generous transition relief will be needed as errors will be made where there is no clear guidance on how the rules are intended to work, and the consequences of an error are rather dire—as they include potential plan disqualification for a plan sponsor, a 50% excise taxes for a beneficiary, a potential annual 6% excise tax for improper IRA contributions, and potential reporting and withholding penalties and interest.

Safe Harbor Plans

The SECURE Act also provided relief for safe harbor plans to make them more attractive, and help save even more for retirement. Their changes are effective immediately, but without IRS guidance there is some concern with proceeding. This largely stems back to the historically limited changes that were permissible mid-year with safe harbor plans. Although the IRS relaxed these rules in Notice 2016-16, it is not clear how the IRS views these changes of lifting the 10% deferral cap to 15% on QACAs and providing relief from safe harbor notices for a non-elective employer contribution safe harbor plan (particularly where the plan also has a match and the plan sponsor is looking for ACP testing relief as well).

Part Time Coverage

The changes that are coming in 2021 for required 401(k) coverage for part-time workers will need careful consideration and clear guidance from the IRS. There are complexities where there are transfers between full-time and part-time status, and where there are various service rules at play within the same plan. Moreover, for the special vesting provision for these workers it will be important to confirm that the provision counts service prospectively, just as is done with the eligibility provision. Any other answer would simply not be administratively feasible.

Plan Amendments

Although we have generous amendment timing relief for plan amendments through 2022, it is important to note that relief is contingent on operational compliance. We would hope the IRS is using a good faith standard for this purpose, as two-week lead time for the most extensive tax changes in years to qualified plans is by no means sufficient.

Moreover, it appears that the change from age 62 to age 59-½ for in-service pension plan distributions is not subject to this broad relief. (There is also no ERISA counter-part for this change; this same concern is also raised for the service provisions under the part-time coverage rules noted above.) Therefore, absent IRS guidance, plan sponsors should be mindful of the typical year-end amendment for discretionary plan amendments for this optional in-service distribution change.

Terminating plans do not have the luxury to wait until 2022 for plan amendments, as terminating plans must be updated for current law prior to termination. And without the standard determination letter cycles, we anticipate the IRS providing more sample amendments, which will be welcomed with these complex SECURE Act changes. For example, most plans follow the sample language from the IRS regarding minimum required distributions, and without guidance on the scope of these new rules, there is real hesitation to proceed without a revised sample amendment.

Conclusion

The SECURE Act provided a number of changes to qualified plans, but full and proper implementation will require IRS and Treasury guidance, which we all eagerly await.