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Round One of SECURE Act IRS Guidance Clarifies Some Key Issues for Retirement Plans

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IRS Notice 2020-68 (Notice) provides the first round of guidance on a number of provisions under the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act) and the Bipartisan American Miners Act of 2019. The key qualified plan provisions are highlighted and summarized below:

- Participation of part-time employees in 401(k) plans
- Qualified birth or adoption distributions
- Changes to in-service distributions from pension plans
- Deadline for plan amendments

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Participation of Long Term Part-Time Employees in 401(k) Plans ("LTPT")

Section 112 of the SECURE Act requires that 401(k) plans allow long term, part-time employees to make elective deferrals once they have reached age 21 and have at least 500 hours of service in three consecutive 12-month periods. This 500 hours of service rule also applies for vesting purposes, even if the participant later becomes a full-time employee when a 1,000 hour rule would generally apply. This provision is effective for plan years beginning after December 31, 2020, with part-timers first becoming eligible under plans in 2024 plan years.

Notice 2020-68 provides limited guidance on how the SECURE Act rules interact with the general rules for counting service for vesting purposes. The new law clearly excludes 12-month periods beginning before January 1, 2021 in determining whether an employee is a long-term

part-time employee eligible to make elective deferrals. And the new law is clear that employers are not required to provide employer contributions to such employees. However, the Notice takes the position that the longstanding rules of Code section 411(a)(4) apply to determine whether LTPT workers are vested in any employer contributions that are made on their behalf. Thus, for example, 12-month periods of service beginning before January 1, 2021 count for vesting in employer contributions unless the service may be ignored under the general rule, e.g., years of service before the employee attains age 18, service when the employer did not maintain the plan or a predecessor plan, etc. See Code sec. 411(a)(4).

This partial retroactive application of the provision, where employers may lack the data to recreate the vesting service, raises concerns and therefore is the initial point of focus for the IRS. The IRS specifically asked for ideas on how best to address this issue, so stay tuned.

Qualified Birth or Adoption Distributions (QBADs)

Section 113 of the SECURE Act added a new in-service distribution provision for "qualified" child births and adoptions – along with a new exception to the 10% additional income tax for early withdrawals – effective for distributions on or after January 1, 2020. In a long line of Q&As, the Notice provides helpful guidance on the scope of the provision that permits an individual, within the one-year period beginning on the date on which a child is born or on which a legal adoption of an eligible adoptee is finalized, to withdraw up to $5,000 for each child/eligible adoptee from an eligible plan or IRA (in the aggregate).

A. Distribution Rules for QBADs

- ***Eligible Plans.*** A QBAD may be made from a 401(k) plan, 401(a) plan (other than defined benefit plans), 403(a) annuity plan, 403(b) annuity contract, and 457(b) governmental plan, or an IRA (an "applicable eligible retirement plan").
- ***Requirements for a Distribution to be a QBAD.*** An individual receiving a QBAD must include the name, age, and Taxpayer Identification Number of the child or eligible adoptee on such individual's tax return for the taxable year in which the QBAD is made.
- ***Eligible Adoptee.*** The adoptee must be under 18 or "disabled" (as defined under Code section 72(m)(7)), and not be a child of the taxpayer's spouse. If the adoptee is 18 or older, he or she must be unable to engage in any substantial gainful activity by reason of a medically determinable physical or mental impairment that can be expected to result in death or to be of a long-continued and indefinite duration.
- ***QBADs to Both Parents.*** Each parent may receive a QBAD of up to $5,000 with respect to the same child or eligible adoptee.
- ***Multiple Births or Adoptions.*** An individual is permitted to receive a QBAD with respect to the birth of more than one child (or the legal adoption of more than one eligible adoptee) so long as the QBADs are made within the one-year period following the birth(s) or finalization of the legal adoption(s). The Notice gives examples of an individual who gives birth to twins in October 2020 and takes a $10,000 distribution from a 401(k) plan in January 2021. Assuming the QBAD

requirements are met (e.g., providing names, ages, etc. of the children), the entire $10,000 is a QBAD.

- ***In-Service Distributions.*** An applicable eligible retirement plan is not required to permit in-service distributions for QBADs. However, an individual may claim the 10% penalty relief for any otherwise permissible plan distribution by taking that position on his or her tax return.
- ***Reasonable Representations.*** The sponsor/administrator of an applicable eligible retirement plan may rely on reasonable representations from an individual that they are eligible to receive a QBAD unless it has actual knowledge to the contrary.
- ***Available Sources.*** A QBAD may be made from elective contributions, qualified non-elective contributions, qualified matching contributions, and safe harbor contributions – amounts that would generally not be permitted to be distributed prior to age 59½.
- ***Not a Rollover Distribution.*** A QBAD is not treated as a rollover eligible distribution from an applicable eligible retirement plan. This means a plan sponsor is not required to (i) offer an individual a direct rollover with regards to a QBAD, (ii) provide a 402(f) notice, or (iii) withhold 20% of the QBAD (though QBADs are subject to 10% withholding, unless the participant opts out).

B. Re-Contribution Rules for QBADs

- ***Recontributions Allowed.*** Any amount of a QBAD may be recontributed to an applicable eligible retirement plan in which the individual is a beneficiary and to which a rollover can be made.
- ***Recontributions Permitted Under Plan Rules.*** An applicable eligible retirement plan must permit recontributions of a QBAD if (i) the plan permits QBADs, (ii) the individual making the recontribution received a QBAD from the plan, and (iii) the individual is eligible to make a rollover contribution to the plan at the time recontributions are made.
- ***Treatment of Recontributions.*** The recontribution of a QBAD to an applicable eligible retirement plan is treated as a direct rollover from another eligible retirement plan. The Notice indicates that additional guidance, via proposed Code section 72(t) regulations, is anticipated.

Earlier in-Service Distributions From Pension Plans Allowed

Section 104 of the Miners Act lowers the minimum age for allowable in-service distributions under Code section 401(a)(36) for defined benefit plans (and money purchase pension plans) from age 62 to age 59½. For governmental 457(b) plans, the Act lowers the minimum age from 70½ to 59½ for in-service distributions. These changes are effective for plan years beginning after December 31, 2019.

The Notice clarifies two important points: (1) the provisions are optional, and (2) these changes have no impact on the plan's definition of normal retirement age.

Deadline for Plan Amendments

Section 601 of the SECURE Act generally provides that plan amendments to reflect the SECURE Act changes must be adopted by the last day of the first plan year beginning on or after January 1, 2022 (2024 for governmental plans), including anti-cutback relief.

The Notice clarifies that this deadline applies to all types of tax-favored plans that are impacted by the provisions of the SECURE Act, including 403(b) plans, governmental 457(b) plans, and 401(a) plans (whether the plans are individually designed or pre-approved documents). The same deadline applies whether the amendment is mandatory, optional/discretionary, or is an interim amendment.

Section 403(b) plans for public schools have until the end of the last day of the first plan year beginning on or after January 1, 2024 to adopt plan amendments, and governmental 457(b) plans have until the later of the end of the last day of the first plan year beginning on or after January 1, 2024 or, if applicable, the first day of the first plan year beginning more than 180 days after the date of notification by the Secretary that the plan was administered in a manner that is inconsistent with the requirements of Code section 457(b).

Next Steps

Plan sponsors and service providers of qualified plans should review this first round of guidance, identify which provisions they must (or would like to) adopt, and consider making the necessary operational changes to their policies and procedures. They also should stay tuned for more guidance.

When considering the QBAD feature, plan sponsors should take into account the various changes necessary to implement the participant-friendly provision (and coordinate with their record-keeper), including: (1) account sources, (2) 1099-R reporting changes, (3) 402(f), rollover and withholding changes, (4) updated Summary Plan Description (or Summary of Material Modification), (5) certification process and coordination for all controlled group plans, (6) recontribution process/procedures, and (7) plan amendment terms.

The IRS is asking for comments by November 2. As noted, this includes how to address the administrative burden for counting vesting service for part-time employees. But as this is just round one, and is not comprehensive guidance, plan sponsors should not rush to adopt SECURE Act plan amendments (unless of course your plan is terminating).