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EMPLOYEE BENEFITS AND EXECUTIVE COMPENSATION

SECURE ACT IMPLICATIONS FOR QUALIFIED RETIREMENT PLANS

The Setting Every Community Up for Retirement Enhancement Act of 2019 (the "SECURE Act" or "Act") was approved in December 2019, and includes a number of provisions affecting qualified retirement plans and IRAs. The provisions likely to be of the most interest to employers sponsoring qualified retirement plans and 403(b) plans are outlined in this LEGALcurrents, along with benefits-related provisions included in companion legislation. While the Internal Revenue Service ("IRS") has issued guidance on some provisions, additional guidance is expected. Accordingly, the analysis in this newsletter may change as more information becomes available.

Required Minimum Distributions

Under pre-SECURE Act law, a participant in a qualified retirement plan, 403(b) plan, or eligible 457(b) plan generally was required to commence "required minimum distribution" payments from the plan no later than April 1st of the year following the year he/she attained age 70½ (or, if the participant was still employed at age 70½ and not a "5% owner" of the employer, as of the April 1st following the year in which the participant terminated employment with the employer). IRA owners were required to commence payment by April 1st after attaining age 70½. The SECURE Act extended this deadline, allowing a participant or IRA owner who had not attained age 70½ by December 31, 2019, to wait until April 1st after the year in which the participant attains age 72 to commence payments. A participant in a plan who is still employed at that point and not a "5% owner" can continue to delay payment until the April 1st after the year in which he/she terminates employment.

The SECURE Act also changed the required minimum distribution rules applicable to non-spousal beneficiaries of deceased participants in defined contribution plans and IRAs. Previously, these beneficiaries could in most cases elect to receive payment of death benefits over their own life expectancies, if the plan permitted. Under the SECURE Act, a beneficiary who is an individual human, or a trust that qualifies to use the individual rules, generally must complete payment from a defined contribution plan (or IRA, as applicable) within ten years of the participant's death, unless the beneficiary is an "eligible designated beneficiary." An "eligible designated beneficiary" is a beneficiary who is the participant's surviving spouse, the participant's minor child (in which case, the ten-year deadline is calculated from the date the beneficiary reaches the age of majority), a beneficiary who qualifies for an exception by reason of a qualifying disability or chronic illness, or a beneficiary who is not more than ten years younger than the participant.

The new rules apply to beneficiaries of defined contribution plan participants and IRA owners who die after December 31, 2019, as well as to successor beneficiaries for beneficiaries of participants who had died on or

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before December 31, 2019, if the original beneficiary dies after December 31, 2019 and before full payment of the account.[1] However, collectively bargained plans and governmental plans have a delayed effective date for these changes, and distribution schedules under qualified annuity contracts that meet specified conditions and were already in effect and binding as of the date of the SECURE Act are not affected.

Spousal beneficiaries continue to have the right to calculate required minimum distribution payments based on their own life expectancies, and to recalculate their life expectancies each year. Spousal beneficiaries also retain the right to delay commencement of payment longer than non-spousal beneficiaries. Under pre-SECURE Act law, the spousal beneficiary of a participant who died prior to the required beginning date could delay payment until the end of the year the participant would have attained age 70½, or until the end of the year after the participant's year of death, if later. The SECURE Act allows the delay to extend until the year the participant would have attained age 72 (or until the end of the year after the year of death, if later), in the case of participants who would not have turned 70½ as of December 31, 2019.

Defined benefit plans' death benefit payment deadlines were not changed by the SECURE Act. Accordingly, defined benefit plan beneficiaries who are individuals or qualifying trusts continue to be eligible to take payment over their life expectancies, if the plan permits.

For both defined benefit plans and defined contribution plans, as well as IRAs, if a participant dies prior to reaching the required beginning date, beneficiaries other than individual humans or qualifying trusts (e.g., a charitable organization, an estate, or a trust that does not meet IRS requirements to be treated as an individual human for this purpose) continue to be subject to the requirement that payment be completed in full by the end of the calendar year containing the fifth anniversary of the participant's death.

The IRS recently proposed regulations reflecting the SECURE Act changes. More information is available in our newsletter at https://hselaw.com/news-and-information/legalcurrents/2626-proposed-updates-to-required-minimum-distribution-and-rollover-regulations-for-retirement-plans.

401(k) Participation

Effective for plan years beginning after December 31, 2020, 401(k) plans must allow part-time employees who meet a reduced service threshold to make elective deferrals. Historically, a 401(k) plan could exclude an employee who had not completed at least 1,000 hours of service in a twelve-month eligibility computation period (i.e., the first 12 months of employment, and thereafter either each twelve-month period beginning on the employment anniversary or each plan year). The new rule requires the plan to allow employees who have not met the 1,000-hour year of service requirement but who have completed at least 500 hours of service in each of three consecutive eligibility computation periods, and who are at least age 21 upon satisfaction of the service requirement, to make elective deferrals. The employer is not required to make employer contributions for these employees and may disregard them for purposes of coverage and

[1] The IRS's recently proposed regulations provide additional guidance for applying the new rules for successor beneficiaries entitled to benefits after an original beneficiary dies, and for situations involving multiple beneficiaries, but beneficiary distribution continues to be a complex topic.

nondiscrimination testing, safe harbor contributions, and top-heavy benefits. However, a 500-hour computation period does count as a year of vesting service for employees eligible under this rule.

The new requirement became effective in the 2021 plan year, but service for computation periods that began prior to January 1, 2021, can be disregarded for purposes of eligibility (although not for purposes of counting total vesting service under the special vesting rule). Accordingly, employers have some lead time before part-time employees must be allowed to make elective deferrals under this rule. The new rule does not apply to collectively bargained employees or non-resident aliens with no U.S.-source income. Practitioners hope that the IRS will provide some greater clarity on how to administer the vesting rules.

401(k) Safe Harbor Changes

Previously, 401(k) plans using a "safe harbor" design to claim exemption from ADP and ACP testing had to provide an annual notice, and in most cases had to include the requisite safe harbor contribution rules before the start of the plan year. The SECURE Act eliminated the notice requirement for safe harbor plans that offer a safe harbor nonelective contribution rather than a safe harbor matching contribution, and which either do not offer any matching contributions at all, or do not seek to qualify for an exemption from testing for matching contributions. In addition, the Act allows an employer to amend its plan to add a safe harbor nonelective contribution feature at any time before the 30th day prior to the end of the plan year (or at any time before the end of the next plan year, if the contribution is at least 4% of compensation, rather than the usual safe harbor minimum of 3%) as long as the plan did not provide for safe harbor matching contributions at any time during the plan year. These options became available for plan years beginning in 2020.

Finally, the SECURE Act increases the 10% cap on automatic enrollment for "qualified automatic contribution arrangement" ("QACA") safe harbor plans to 15% (except for the first year of automatic enrollment, when the maximum permissible automatic enrollment amount remains at 10%). Since that provision took effect for plan years beginning in 2020, QACA plans were permitted (or required, if the plan incorporates the statutory limit by reference and is not timely amended) to increase automatic deferrals for participants automatically enrolled for more than one year who would otherwise be affected by the 10% limit in 2020. The IRS has not provided any specific guidance on how to apply the new limit to existing plan participants who have been at the 10% limit for more than a year already.

Birth/Adoption Distributions

Since January 2020, a defined contribution plan (including defined contribution qualified retirement plans, 403(b) plans, and governmental eligible 457(b) plans) or an IRA could, but was not obligated to, offer qualified birth or adoption distributions to eligible participants. If a plan offers this feature, a participant may take a distribution from a defined contribution plan (including defined contribution qualified retirement plans, 403(b) plans, and governmental eligible 457(b) plans) or an IRA of up to $5,000 within a year of the birth or qualifying adoption of a child, without being subject to the Section 72(t) 10% tax penalty on early distributions. A plan may allow this type of payment even if the participant is not otherwise eligible for a distribution, and pursuant to guidance issued by the IRS, the plan may rely on reasonable

representations from a participant that the participant is eligible for such a qualified birth or adoption distribution, unless the plan has actual knowledge to the contrary.

A birth/adoption distribution is not subject to the mandatory 20% tax withholding and disclosure rules applicable to rollover-eligible distributions, but may be repaid to the source plan if the employee is otherwise entitled to contribute to that plan, or to an IRA. Such a repayment is treated as if it were received as a rollover-eligible distribution and was subsequently rolled over in a direct trustee-to-trustee transfer within 60 days of the distribution. Additional IRS guidance will be necessary to clarify the extent to which an employee can choose to request a direct rollover even if he or she would by chance qualify for the birth/adoption rules, and to provide additional details with respect to the rules related to the timing of subsequent repayments of these distributions.

Nondiscrimination Testing Relief for Frozen and "Soft-Frozen" Defined Benefit Plans

The SECURE Act liberalized nondiscrimination and minimum participation rules for defined benefit plans which no longer permit new employees to participate but which do allow continued benefit accrual by existing plan participants, if certain requirements are met. The Act also included provisions intended to facilitate contributions to defined contribution plans intended to make up for or offset the impact of the freeze of a defined benefit plan, in specified circumstances.

Defined Contribution Plan Lifetime Income Options

In order to facilitate lifetime income options and retirement planning, the SECURE Act:

- Required the Department of Labor to provide guidelines for calculating lifetime income projections for defined contribution plan statements and model disclaimers to be included with those projections, which the Department of Labor provided in the form of an interim regulation. Plan administrators are now required to include life annuity and joint & 50% survivor annuity projections at least once annually on defined contribution plan statements and are protected against liability for discrepancies between the projections (calculated based on the Department's guidelines and accompanied by the model disclaimers) and actual results. Generally, for participant-directed plans, the requirement to include lifetime income illustrations on participant statements took effect with the second quarter statements for 2022, and for most non-participant-directed plans (i.e., calendar year plans), the lifetime income illustrations had to be included on the 2021 participant statement issued in 2022.
- Allows defined contribution plan participants to receive distributions, via rollover to an IRA or in the form of an annuity contract, of lifetime income products if the plan ceases to allow those products as investments. These distributions can be made even if the participant would not otherwise meet the legal threshold to receive a distribution.
- Protects fiduciaries selecting insurance companies as annuity providers for defined contribution plans from liability in the event the provider defaults on payments in the future, if certain conditions were met at the time the provider was selected. Those conditions include an appropriate investigation of the insurance company's financial ability to meet its payment obligations, but the fiduciary is permitted to rely (absent knowledge to the contrary) on certain representations from the insurer in that regard.

"Open" Multiple Employer Plans

Previously, the Department of Labor restricted the ability of a vendor to offer a single retirement plan to unrelated clients. Effective for plan years beginning after 2020, employers can join a "pooled" defined contribution plan of this type offered by a qualifying provider, so long as the pooled plan contains certain specified provisions. The SECURE Act also contains provisions protecting innocent employers against the consequences of another employer's portion of the plan breaching legal requirements and losing tax-qualification.

However, an employer that chooses to join one of these arrangements should be aware of its fiduciary responsibility for selection of the pooled plan vendor (even if that vendor assumes fiduciary responsibility for actual administration and investment oversight). In addition, the employer should be sure it understands the potential complications it may experience if it later wants to discontinue participation in the pooled plan in favor of joining a different pooled plan, establishing its own plan, or joining a plan offered by an acquiring company in the wake of an acquisition, although pooled plans are prohibited from imposing unreasonable restrictions on cessation of participation.

Community Newspaper Pension Funding

The SECURE Act offered pension funding relief for qualifying community newspaper publishers. Employers in this category should review the rules with their actuaries.

403(b) Plans

Under the SECURE Act, the IRS was required to issue guidance with respect to allowing in-kind distributions of 403(b) custodial accounts from terminating plans. This guidance, released in November 2020, aligned the termination options for plans with these accounts with the options available to terminating plans that offered 403(b) annuity contracts. The SECURE Act also clarified participation rules for Section 403(b)(9) retirement income accounts for employees of certain church-controlled organizations.

New Plans and Tax Credits

Small employers may qualify for an increased tax credit if they start a new plan. The SECURE Act also allowed employers (regardless of size) additional time to adopt a plan by extending the adoption deadline to the deadline for the employer's tax return. It remains to be seen whether this new provision will affect the IRS' view that a cash or deferred arrangement must be adopted in advance of the date elective deferrals begin.

An additional tax credit is also available for small employers that offer automatic enrollment as part of a new plan, or as a new feature for an existing plan.

Penalty Increases

The SECURE Act increased the Internal Revenue Code penalties applicable for failure to file Form 5500 and Form 8955-SSA, as well as for failure to provide certain updates regarding the plan's status and contact information. It also increased penalties associated with failure to provide proper tax-withholding disclosures.

Form 5500 Filing

The Department of Labor and the IRS were required to modify Form 5500 so that a group of plans with the same trustee, plan administrator, named fiduciary, plan year, and investment options can file a consolidated Form 5500. This option will be available on the Form 5500 for the 2022 plan year.

No Credit Card Loans

Qualified retirement plans are prohibited from offering participant loans via credit card or similar arrangements, effective immediately upon the enactment of the SECURE Act.

In-Service Distributions for Pension Plans

Due to a change made by the Bipartisan American Miners' Act, enacted at the same time as the SECURE Act, pension plans will now be allowed to make in-service distributions beginning at age 59½, rather than being required to wait until a participant is at least age 62.

Plan Amendments

SECURE Act and Bipartisan American Miners' Act amendments originally were due by the end of the 2022 plan year, with collectively bargained and governmental plans having an extended deadline. However, the IRS has extended the deadline to December 31, 2025, with extended deadlines available for government plans. The IRS also issued a conforming extension for amendments reflecting the expanded distribution and loan access and required minimum distribution suspension provisions of the Coronavirus Aid, Relief and Economic Security Act of 2020 (the "CARES Act"), which also originally had been due during the 2022 plan year.

For More Information

As always, please feel free to contact a member of the Employee Benefits & Executive Compensation group at 585.232.6500, 716.853.1316, or visit www.hselaw.com or more information about the items discussed in this newsletter, or for assistance in other matters.