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Pre-COVID-19 Legislation Contains Key Retirement Plan Provisions

Although the news has been dominated by the COVID-19 pandemic for the past four months, employers should be aware that late last year, in a rare act of bipartisanship, Congress passed the Further Consolidated Appropriations Act of 2020, which includes numerous provisions affecting a broad array of employee benefit plans. The vast majority of the applicable provisions are found in the Setting Every Community Up for Retirement Enhancement Act (SECURE Act), although additional provisions are found in the Bipartisan American Miners Act of 2019 (Miners Act) and the Tax Certainty and Disaster Tax Relief Act of 2019. These provisions became law on December 20, 2019, when President Trump signed the bill.

The legislation, though broad in scope, contains key provisions that are of particular interest to employers sponsoring retirement plans subject to the provisions of Section 401(a) of the Internal Revenue Code of 1986, as amended, referred to as Qualified Plans. This article summarizes certain provisions regarding the nondiscrimination rules and the distribution and withdrawal options applicable to Qualified Plans that became effective either upon enactment or for plan years beginning on or after January 1. Where applicable, this article also highlights the steps plan sponsors should take to administer these provisions, including the deadlines for any required plan amendments, and the similar but different provisions contained in the Coronavirus Aid, Relief and Economic Security Act (CARES Act).

Key Nondiscrimination Rule Changes

Relief for Defined Benefit Qualified Plans Subject to a "Soft" Freeze

Plan sponsors have used a variety of techniques to help control the costs of defined benefit pension plans. One technique, known as a "soft" freeze, occurs when a plan closes to new participants but continues to accrue benefits for existing participants, i.e., the "frozen population." Other strategies, such as freezing certain benefits, like an early retirement subsidy, are also employed. Regardless of the technique employed, defined benefit pension plans remain subject to the nondiscrimination rules applicable to Qualified Plans, even after they experience a soft freeze. Unfortunately, as the frozen population dwindles, it becomes difficult for these plans to continue to satisfy the nondiscrimination rules. As a result, many plan sponsors have been forced to adopt a "hard" freeze, meaning no future accruals can be made for the benefit of the frozen population.

In general, effective as of December 20, 2019, the SECURE Act permits closed defined benefit pension plans to be aggregated with one or more defined contribution plans to demonstrate that the closed defined benefit plan is not discriminatory. This relief is available only if the soft freeze occurred before April 5, 2017, or if the soft freeze occurs after the plan has been in effect for at least five years and no substantial increase in benefits was adopted during the five-year period preceding the close. Additionally, there can be no modifications affecting the frozen population to the extent the modifications themselves would be discriminatory.

Enhancements to 401(k) Safe Harbor Plans

Safe harbor 401(k) plans provide for automatic compliance with certain nondiscrimination rules if the employer contributes either safe harbor matching contributions or safe harbor nonelective contributions. In general, safe harbor plans had to be effective for the entire plan year and had to notify eligible employees of the plan's safe harbor status prior to the beginning of the year. An exception permitted plans to be amended after the beginning of the plan year to provide for safe harbor nonelective contributions, if the amendment was made no later than 30 days before the end of the plan year and certain other requirements were met, such as distribution of a supplemental notice and plan terms regarding the nondiscrimination testing method to be used (i.e., the current-year testing method rather than the prior-year testing method).

Effective for plan years beginning on or after January 1, the SECURE Act eliminates the advance safe harbor notice requirement for plans seeking to satisfy the safe harbor 401(k) requirements by making safe harbor nonelective contributions. Accordingly, plan sponsors that satisfy the safe harbor requirements by making safe harbor nonelective contributions are relieved from providing the safe harbor notice prior to the beginning of each plan year.

Additionally, plan sponsors that wish to amend their plans to provide for safe harbor nonelective contributions after the start of the plan year will be subject to less onerous requirements. Specifically, plans may be amended prior to the 30-day period preceding the end of the plan year without providing a supplemental notice and without regard to the method chosen to demonstrate nondiscrimination. If the plan is amended within 30 days of the end of the plan year, but no later than the end of the immediately following plan year, the plan may still be a safe harbor, provided the amount of the nonelective contributions are at least 4% of compensation.

Increase in Qualified Automatic Contribution Arrangement Rates

A Qualified Automatic Contribution Arrangement (QACA) is a type of 401(k) safe harbor plan that allows for the automatic enrollment of employees. Previously, the maximum rate at which an employee's compensation could automatically be deferred under a QACA was 10%.

Effective for plan years beginning on or after January 1, the SECURE Act increases the maximum rate at which an employee's compensation can automatically be deferred under a QACA from 10% to 15%. However, the maximum automatic contribution rate for the first plan year in which an employee participates still cannot exceed 10%.

Plan sponsors wishing to increase the maximum QACA contribution rate should review their plan enrollment materials and amend their plan documents, as the percentages must be stated in the plan document. Since the SECURE Act provides that, in general, plan sponsors will have until the last day of the plan year that begins in 2022 or such later date as the Secretary of the Treasury may prescribe to amend their Qualified Plans, the actual plan amendment can be timely adopted at a later date. This deferred amendment date is similar to the deferred amendment date provided under the CARES Act.

Key Distribution and Withdrawal Changes

Deferred Required Beginning Date

In general, Qualified Plans must begin distributing benefits (required minimum distributions) by the Required Beginning Date, which prior to the SECURE Act was April 1 of the calendar year following the calendar year in which the participant reached age 70 ½, or, if provided by the terms of the Qualified Plan, April 1 of the calendar year following the later of the calendar year in which the participant reached age 70 ½ or terminated employment.

Effective for required minimum distributions to be made on or after January 1, the SECURE Act increases the age for determining the Required Beginning Date to age 72 for individuals who attain age 70½ on or after January 1. In other words, for individuals who attain age 70½ on or after January 1, their Required Beginning Date will be now be the later of April 1 of the calendar year following the calendar year in which the participant reaches age 72, or the calendar year in which the participant terminates employment (assuming the Qualified Plan uses a "later of" definition).

The SECURE Act's provisions should not be confused with the relief provided under the CARES Act, which permits required minimum distributions from defined contribution plans for calendar year 2020 to be waived.

Plan sponsors should review and revise their employee communications and plan procedures to change the date at which mandatory distributions must begin. In addition, amendments to the plan will be required. The general deferred amendment period of the SECURE Act applies to this change, so the required plan amendment need not be adopted until the last day of the plan year that begins in 2022 or such later date as the Secretary of the Treasury may prescribe. This deferred amendment date is similar to the deferred amendment date provided under the CARES Act.

Plan Withdrawals for Birth or Adoption

In general, elective deferrals to 401(k) plans cannot be distributed prior to terminating employment, unless the participant has attained age 59½ or experiences a hardship. Distributions from Qualified Plans are generally included in income in the year in which the distributions are made, and, if made before age 59½, are subject to a 10% early distribution penalty. Additionally, distributions from Qualified Plans that would otherwise be eligible for rollover to another plan or an IRA, e.g., taken as a lump sum, are generally subject to a 20% mandatory withholding of federal income tax unless they are actually rolled over.

Effective for plan years beginning on or after January 1, the SECURE Act permits "qualified birth or adoption distributions," i.e., any distribution of up to $5,000 (per birth or adoption) taken within one year of the birth or adoption. These distributions are exempt from the 10% early distribution penalty, the 20% mandatory withholding, and certain disclosure requirements. In addition, these distributions can be repaid to the Qualified Plan without regard to the usual 60-day time limit for rollovers.

Again, the SECURE Act's provisions should not be confused with the "Coronavirus-Related Distributions" (CRDs) included under the CARES Act. While CRDs are available in much larger amounts (up to $100,000), they are conditioned on satisfying certain criteria specifically related to the coronavirus and are available only during calendar year 2020. Accordingly, plan sponsors may wish to add the ability for participants to take qualified birth or adoption distributions.

The SECURE Act does not clearly mandate that a Qualified Plan specifically provide for qualified birth or adoption withdrawals. If the recent guidance regarding CRDs is any indication, plan sponsors may need to develop procedures for identifying these distributions for purposes of meeting the applicable, and to amend their plans, but only if they choose to treat withdrawals as qualified birth or adoption distributions. Additional guidance on this point would be welcome.

In-Service Distributions for Pension Plans

As noted in the preceding section, distributions from Qualified Plans are limited while a participant is actively employed. Defined benefit pension plans may not permit in-service distributions prior to the time a participant attains age 62.

Effective for plan years beginning on or after January 1, the Miners Act permits in-service distributions from defined benefit and defined contribution money purchase plans to be made upon attainment of age 59½. Plan sponsors of defined benefit and defined contribution money purchase plans should determine whether they want to add this feature and, if so, should revise their distribution procedures and amend their plan documents. In contrast to the SECURE Act, the Miners Act does not expressly provide for a deferred amendment period. Therefore, plan sponsors should ensure that any required amendment is timely adopted by the end of the plan year for which it is effective.

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