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Fall 2020

CARES ACT AND RETIREMENT PLANS (WHAT YOU SHOULD KNOW)

The Coronavirus, Aid, Relief, and Economic Security (CARES) Act signed on March 27, 2020, contained several provisions related to eligible retirement plans. Some of the provisions are options such as the distribution and loan provisions while others are mandatory, namely the waiver of 2020 required minimum distributions.

CORONAVIRUS RELATED DISTRIBUTIONS

Under the CARES Act, eligible retirement plans can allow a qualified individual to withdraw up to $100,000 from their account. These distributions are exempt from the 10% early withdrawal penalty and income tax withholding at the time of distribution.

Individuals are able to pay tax on the income from the distribution ratably over three years. These loans can also be paid back within three years.

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The plan sponsor can rely on the participant's certification that they are qualified.

The CARES Act defines a qualified individual as someone:

- Who is diagnosed with COVID-19;
- Whose spouse or dependent is diagnosed with COVID-19;
- Who experiences adverse financial consequences as a result of being quarantined, furloughed, laid off, having work hours reduced, being unable to work due to lack of child care due to COVID-19, closing or reducing hours of a business owned or operated by the individual due to COVID-19; or
- Other factors as determined by the Treasury Secretary

INCREASED LOAN LIMITS AND DELAYED PAYMENTS

The CARES Act allows the plan loan limit to be increased, for a qualified individual, to the lesser of $100,000 or 100% of a participant's balance for 180 days after the Act was signed.

Plan loan payments from March 27, 2020 through December 31, 2020 can be delayed for up to one year subject to plan approval. Interest will continue to accrue on the loan and at the end of the deferment the loan will be reamortized and the term of the loan can be extended for up to one year.

Similar to the Coronavirus related distributions, the plan sponsor can rely on the participant's certification that they are eligible.

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CARES ACT AND RETIREMENT PLANS

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WAIVER OF 2020 REQUIRED MINIMUM DISTRIBUTIONS (RMDS)

The requirement for required minimum distributions has been waived for 2020. This waiver also includes initial RMDs for 2019 that were not completed during 2019. Individuals that have already received their 2020 RMD are eligible to rollover the distribution and defer paying taxes with a 60-day rollover. *IRS Notice 2020-51 extends the amount of time to repay the RMD to an IRA to August 31, 2020.*

DELAYED CONTRIBUTION DEADLINE FOR DEFINED BENEFIT AND MONEY PURCHASE PLANS

Contributions due to a defined benefit or money purchase plan in calendar year 2020 have a delayed due date to January 1, 2021. The employer must pay interest on the delayed payments from the original due date to the payment date.

PLAN AMENDMENTS

If the qualified plan utilizes the distribution or loan provisions the plan must be amended no later than the end of the plan year beginning on or after January 1, 2022.

by Bethany Hulbert

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FAILING TO ENROLL ELIGIBLE EMPLOYEES IN YOUR PLAN

What to watch out for and how to fix it. *Administrative glitches are practically inevitable at some point when operating a retirement plan, given the myriad ways things can get off track. Case in point: inadvertently failing to add a newly eligible employee to your roster of 401(k) plan participants. While excluding an eligible employee isn't the worst mistake you could make, it's important to identify the error sooner rather than later and take prompt remedial action.*

COMMON ERRORS

According to the IRS, typical causes for such errors include:

- An employer's faulty assumption that the plan doesn't need to cover some part-time employees, or
- Considering employees ineligible to participate because they choose not to make elective deferrals.

What kind of remedial action is called for? You need to go beyond simply reclassifying the employee as a participant; the IRS has very specific instructions on what to do. But before you dive into that, it's often helpful to verify that you're clear on how your plan document defines eligibility.

ERISA STANDARDS

Although ERISA sets some minimum standards for defining eligibility, sponsors are free to be more generous. Under ERISA, an employee is eligible if the employee has attained age 21 and has completed a year of service (defined as a consecutive 12-month period) in which the employee has logged at least 1,000 hours of work. This is referred to as the maximum statutory requirement for eligibility. When using these requirements, a plan must allow the employee to enter the plan no later than six months after meeting the requirements.

ERISA regulations elaborate on these minimum requirements. For

FAILING TO ENROLL ...

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example, they define the starting point for calculating service time, among other issues. Check with your benefits specialist or third-party administrator (TPA) to review the details.

So what do you need to do if you've failed to timely enroll a participant? If you fix the error in less than three months after the employee should have been added to the plan, you're off the hook. If not, the regulations require you to make a corrective qualified nonelective contribution (QNEC) to that participant's account.

CALCULATING A QNEC

The regulations create a basic two-step formula for determining the amount of the QNEC: First, take the actual deferral percentage (ADP) for the employee's category — such as nonhighly compensated employee (NHCE) or highly compensated — and multiply it by the employee's compensation during the period that he or she was eligible to participate but was mistakenly deemed ineligible. Second, multiply that number by 50%. The regulations reduce the 50% multiplier to 25% if you meet specific requirements and provide the affected employee with a notice within 45 days of being given the opportunity to make deferrals describing the failure and the correction being taken.

For example, suppose employee Mark was in the NHCE group and that group's ADP was 8%. Mark's annual compensation was $60,000, and he was wrongly excluded from participation for nine months. The math would be: $45,000 (earnings during that nine-month period) × 8% × 50% = $1,800.

QNEC contributions are automatically fully vested in the employee's 401(k) account. Different deadlines apply to errors made in plans that use auto-enrollment, and some "safe harbor" remediation alternatives are available. Again, check with your benefits specialist or TPA for the details. Don't forget that any missed employer contributions, such as matching or profit sharing contributions, must be made to the accounts of affected participants.

NOTIFYING PARTIES OF THE FIX

The IRS considers inadvertently neglecting to enroll an employee in your plan when the eligibility period has begun an "operational error." That means you must remedy it using the IRS's "Self-Correction Program" without notifying the agency itself. If the operational error is "significant" (based on subjective criteria defined by the IRS), you may need to file with the IRS under its Voluntary Correction Program. In any event, you need to notify the affected employee/participant of what has happened. The required contents of the notice can be found in Rev. Proc. 2016-51.

OUR COMMITMENT

OUR COMMITMENT TO OUR CLIENTS FUELED BY OUR VALUES:

- **COLLABORATIVE AND MENTORING:** We develop our people and build strong relationships. We blend working hard and having fun. We are a team.
- **ACCOUNTABLE:** We do what we say. Build trust.
- **RESPECT AND INTEGRITY:** We never waver from the highest standards of integrity, respect and ethics. Do the right thing.
- **EXCELLENCE:** We pursue excellence in everything we do. Be awesome.
- **STRIVE:** We have a growth mindset. We are entrepreneurial, curious and challenge ourselves and others. Do great things.

Then you must actually make the fix by the end of the second plan year after the year the error occurred — or have it "substantially corrected within a reasonable period of time."

There's no specific deadline to fix "insignificant" operational errors.

PREVENTION IS KEY

An ounce of prevention is worth a pound of cure. Following those procedures, along with reviewing this subject with your plan's employee benefits specialist, should help you avoid QNEC obligations and possibly straining your relationships with impacted employees.

IRS RECOMMENDATIONS FOR AVOIDING ENROLLMENT ERRORS

The IRS urges plan sponsors to take the following steps to avoid making mistakes around employee eligibility for plan participation:

- **Check how your plan document defines "employee" and plan participation eligibility requirements.**
- **Train (or retrain) any employees who determine eligibility to participate in your plan.**
- **Review payroll records for the total number of employees, birth dates, hire dates, hours worked and other pertinent information.**
- **Check W-2 forms and state unemployment tax returns and compare the employee data they contain with your payroll records for any discrepancies.**

Most important, create protocols and have a corrective action plan that will be triggered when you identify errors.

IRS LIBERALIZES AVAILABILITY OF SELF-CORRECTION PROGRAM FOR PLAN "FAILURES"

If your plan offers participants a plan loan option and you're not infallible, here's some good news: A recent IRS Revenue Procedure allows plan sponsors to jump through fewer hoops to fix several so-called "plan failures" relating to plan loans.

Specifically, plan sponsors can now fix more categories of loan glitches using the streamlined Self-Correction Program (SCP) under the IRS's umbrella Employee Plans Compliance Resolution System, instead of the more burdensome Voluntary Correction Program (VCP).

SCP AND VCP FIXES

Under the SCP, you can fix certain plan failures on your own without having to deal with the IRS or pay any fees. The program is intended to correct "operational errors," meaning you didn't follow the terms of your plan.

The VCP program, in contrast, involves sending the IRS an explanation of the error you'll be correcting along with a fee in the $1,500 to $3,500 range, depending on the size of your plan. You'll also need to explain how you intend to correct the error. You then must wait until the IRS accepts your proposed fix before you're back in its good graces.

"INSIGNIFICANT" ERRORS

The SCP is an option for errors that the IRS considers "insignificant." However, it also includes errors considered significant if you correct them by the end of the second year following the plan year in which the error occurred. One category of error that is automatically classified as "significant" involves plan document failures, meaning noncompliant provisions within your plan document.

In contrast, IRS Revenue Procedure 2019-19 covers administrative errors, such as plan loan mistakes. For example, using the SCP, instead of the previously required more time-consuming and costly VCP method, plan sponsors can now self-correct mistakes involving:

- Loans exceeding the $50,000 ceiling,
- Loans with payment schedules beyond the five-year maximum payback period (longer periods are possible if the loan is used to buy a primary residence), and
- Failure to properly address plan loan defaults.

In all three scenarios, unless you're able to make the necessary correction in time, you must report that the plan participant has received a "deemed distribution." The amount of money involved then becomes taxable.

STEPS TO CORRECTION

Rev. Proc. 2019-19 spells out the specific steps you need to take to fix the problems to be eligible for the SCP approach. For example, fixing a loan exceeding the $50,000 cap can be addressed if the excess amount is promptly repaid. That's simple enough, but the revenue procedure spells out three ways that loan payments — made before your realizing the amount borrowed exceeded the limit — are applied to reducing the excess principal.

When the loan period exceeds the five-year limit, fixing it in a way that lets you use the SCP involves re-amortizing the loan "over the remaining period of the proper payment period measured from the original date of the loan," according to the IRS. Thus, for example, if you discovered that a loan was set up with a six-year amortization schedule instead of the maximum of five years, and you make that discovery two years after the loan was made, you'd need to re-amortize the loan so that it's paid off in three years (bringing the total to five) instead of four.

MAKE THE FIX

Using the SCP to fix plan errors is better that addressing them after they're detected by the IRS in an audit. The agency prefers that you identify your own mistakes and come clean. Check with your plan administrator to ensure that new procedures are put in place to allow you to take advantage of the more liberal self-correction procedures. As with all ERISA rules, the devil is in the details.

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