A NON-TECHNICAL REVIEW OF QUALIFIED RETIREMENT PLAN LEGISLATION & ADMINISTRATIVE ISSUES

2022 – An Ideal Time to Review Plan Design

Each year, those in the retirement community collect, analyze and calculate data to ensure plan compliance with the laws that govern qualified retirement plans. The calendar of deadlines repeats each year, challenging plan sponsors and service providers to focus on the current plan compliance along with the myriad of changes that have come into effect in the last few years. In addition, the COVID-19 pandemic created many financial difficulties and workplace changes for millions of employees and business owners. So, keeping abreast of the 'normal' routine of retirement planning, compliance has become anything but 'normal.'

However, as we embrace our new work environment, there's never been a better time for employers to reevaluate their current plan design. This is an opportunity to add or update features that align with changes to the company's employee demographic and their business objectives and retirement plan goals, as well as take into account the effect of new regulations.

So, what's happening in 2022? The Internal Revenue Service requires all qualified retirement plans to update their plan documents every six years. These updates are intended to reflect legislative and regulatory changes that occurred since the last restatement. For defined contribution plans, the most recent restatement cycle (called Cycle 3) opened on August 1, 2020 and will close on July 31, 2022. This is an important deadline because all plan documents, unless drafted in late 2020 or later, must be restated and adopted by employers by July 31, 2022. This restatement is mandatory and, if missed, plans will be considered out of compliance and employers may face IRS penalties.

The restatement period provides employers with an opportunity to enhance their existing retirement plans — especially if demographics, operations or hiring strategies at the company have changed. The timing of Cycle 3 means that recent changes, such as the hardship distribution regulations effective in January 2019, the SECURE Act of 2019, and the CARES Act of 2020, will need to be addressed in separate, good-faith amendments and will not be included in this restatement period. Cycle 3 restatements will, however, include language pertaining to regulatory changes enacted prior to February 1, 2017. These changes include:

- Expansion of the definition of "spouse" to include those of the same gender;
- Availability of plan forfeitures to offset additional types of company contributions;
- Ability to amend safe harbor 401(k) plans once the year has already started;
- Creation of in-plan Roth transfers.

Plan document restatement cycles give employers and service providers an opportunity to look at the retirement plan as a whole and evaluate the effects that law changes have on the effectiveness of the overall design and goals for the plan and its participants. For many employers and employees, COVID-19 had a detrimental impact on the ability to contribute to the plan. Additionally, many individuals found themselves withdrawing funds from their retirement savings, creating a downturn that will be challenging to recover from. So, a restatement, while mandatory, gives the employer an opportunity to implement solutions that can help individuals get back on track. Some plan design options to consider are listed below:

Eligibility: Eligibility defines how and when employees can join your retirement plan. Though your current eligibility requirements may fit the company's employee demographic for full-time employees, the SECURE Act permits long term part-time employees (LTPTs) the ability to enter the plan starting in 2024, provided that they have satisfied the legally mandated requirements. Though SECURE Act law will not be included in this restatement, it seems wise to explore the effects that LTPT employees may have on your plan's design and filing requirements.

Implement or expand auto-enrollment: Auto-enrollment enables employers to automatically enroll new hires into the retirement plan. Employees can always opt out of auto-enrollment if they decide they do not want to participate in the plan. Auto-enrollment has proven to be a successful tool in expanding retirement plan usage, especially among younger employees. According to a Principal Retirement Security Survey in July 2021, 84% of workers that were automatically enrolled in their workplace retirement plan say they started to save for retirement earlier than if they had to take action to make the enrollment decision on their own. To further help maximize savings and improve outcomes, employers may want to consider enrolling new employees at a higher deferral rate, such as 6%, rather than the standard 3%. The 6% rate will be far more meaningful for retirement and, though there is a risk that more participants could opt-out of the plan, a 2020 report released by John Hancock states the opposite to be true.

Under the SECURE Act, an eligible employer that adds an auto-enrollment feature to their plan can claim a tax credit of $500 per year for a three-year taxable period beginning with the first taxable year the employer includes the auto-enrollment feature.

Increase re-enrollment adoption: Re-enrollment has become increasingly important due to the effects of the COVID-19 pandemic. In a white paper for Voya Financial, Shlomo Benartzi, professor emeritus at UCLA Anderson School of Management, suggested frequently re-enrolling existing participants. He pointed to the U.K., where plan providers are required to automatically re-enroll workers every three years, even if they've previously opted out. Principal's study group stated that they were glad their savings had been "jump-started" and reinforced that, if left to make the decision on their own, many wouldn't have joined or would have at least delayed their enrollment.

Implement or expand auto-escalation: With auto-escalation, employees' contributions are automatically increased every year. For example, employers can increase deferral rates by 1% each year up to a maximum of 15% of pay.

Redesign matching contributions. The pandemic has pressured many employers to discontinue or reduce their 401(k) contribution matches. Rebooting the matching contributions will go a long way in revitalizing employee interest in your plan. If the previous formula does not fit economically, employers might consider reducing the overall matching percentage but increase the cap on contributions (Example: 50% match up to 4% of pay changed to 25% up to 8%). This approach encourages the participant to defer a higher percentage of pay to receive the full matching contribution.

Dr. Benartzi suggested considering a fixed amount matching formula. From the participant's perspective, a dollar amount seems more real than applying percentages to one's paycheck. "Psychologically, it's easy to give up a 6% match, but it's hard to let go of a $1,200 lump sum," he wrote.

The pandemic presented unprecedented challenges for employers that offer retirement plan benefits. With the future looking brighter and the Cycle 3 restatement deadline around the corner, now is the optimal time for business owners to review, and if necessary, update their plan design to align with the company's goals and changing employee demographics.

SECURE Act Provisions for Long-Term Part-Time Employees

Historically, 401(k) plans could exclude individuals who worked less than 1,000 hours in the plan year. However, in its effort to expand access to employer retirement plans, the Setting Every Community Up for Retirement Enhancement (SECURE) Act introduced the concept of a "long-term, part-time employee" (LTPT). The Act requires that starting in 2024, 401(k) plans permit LTPTs the opportunity to elect to make salary deferrals to a 401(k) plan.

So, why talk about it now if not effective until 2024? The definition of an LTPT employee is as follows:

- An employee who has completed three consecutive 12-month periods with at least 500 hours of service during each of those periods, and
- Who has reached the age of 21 by the end of the three-year period.

Eligibility - Since eligibility will be determined based upon hours worked in 2021, 2022 and 2023, plan sponsors and service providers must accurately track and report hours for LTPT employees. LTPT employees who meet these requirements must be allowed to contribute salary deferrals to the plan. However, they may be excluded from employer contributions and nondiscrimination testing. Employees covered by a collective bargaining agreement are not covered by the LTPT rules.

The law pertaining to LTPT employees may create dual eligibility requirements under the plan, assuming that the plan's existing eligibility requirements are not as favorable as those required for LTPT employees. Plan sponsors and their service providers must monitor both the existing service requirement and the eligibility requirements applicable to LTPT employees.

Employer Contributions - LTPT employees may be excluded from employer matching and profit-sharing contributions, as well as safe harbor contributions under a safe harbor 401(k) plan. However, if an LTPT employee satisfies the general minimum age and service requirements by completing at least 1,000 hours of service, they become eligible to participate in employer contributions.

Vesting - In retirement plans, employees, LTPT or otherwise, are always 100% vested in their salary deferral accounts. So, the subject of vesting only applies if an employer voluntarily elects to include LTPT employees in their company contributions that are subject to a vesting schedule. LTPT years of service for vesting purposes must include each 12-month period during which the employee has 500 hours of service or more for all years, including 12-month periods before January 1, 2021.

The main objective of the LTPT rules was to expand retirement coverage to a greater number of working Americans. However, the rules can have significant effects on plans designed under prior law. The possible entry of previously excluded employees and the maintenance of dual eligibility requirements can put an extra burden on plan sponsors and service providers. Considering this new requirement, reviewing the plan's design is an important "to-do" for 2022.

Navigating the Labyrinth of Required Minimum Distributions

Since the passage of the Tax Reform Act of 1986, taxpayers have been required to withdraw previously untaxed dollars from their qualified plan and IRA accounts. These withdrawals are called Required Minimum Distributions or RMDs. Historically, those at and over the age of 70 ½ must take annual withdrawals from their tax deferred accounts including IRAs, SEP IRAs and 401(k) plans. An RMD is calculated by dividing the previous year's balance by a life expectancy factor issued by the IRS. For rules that have remained relatively unchanged for over 30 years, RMD policy has had quite an overhaul starting with the changes made by the SECURE Act in 2019 and then, again, with the CARES Act in 2020. As a result of these changes, account owners and beneficiaries have three sets of RMD rules for 2020, 2021, and 2022.

The required minimum distribution rules came into effect in the late 1980s with the passage of the Tax Reform Act of 1986. Plans affected by RMD rules are:

- 401(k) Plans
- Roth IRAs (RMDs not required while the original owner is still living)
- 403(b) Plans
- 457 Plans
- Traditional IRAs
- Simplified Employee Pensions (SEP) IRAs
- Savings Incentive Match Plans for Employees (SIMPLE) IRAs

Note: Defined Benefit and Cash Balance plans satisfy their RMDs by starting monthly benefit payments (or a lump sum distribution) at the participant's required beginning date. Health Savings Account balances are not subject to the RMD rules.

The SECURE Act, passed into law in late 2019, changed the age at which accounts subject to RMD rules had to start receiving RMDs. If the account holder reached age 70 ½ in 2019, the prior law applied and the first RMD was required by April 1, 2020. If the account holder reached age 70 ½ in 2020 or later, they must take their first RMD by April 1 of the year after turning age 72. Sounds easy, right? But wait…

In 2020, the CARES Act waived RMDs for account holders, including individuals who reached age 70½ in 2019 and had an RMD due in 2020, or had their first RMD due by April 1, 2021. The waiver did not delay distributions in defined benefit and cash balance plans.

However, in 2021, the CARES Act waiver for RMDs was not extended. That means account holders that are subject to RMD rules must make the required distributions for 2021.

- If you reached age 70½ in 2019, your RMDs due in 2020 were waived. You had a 2021 RMD due by December 31, 2021, based on your account balance on December 31, 2020.
- If you reached age 72 in 2021 (and didn't reach 70 ½ in 2019), your 2021 RMD is due by April 1, 2022, based on your account balance on December 31, 2020. Your 2022 RMD is due by December 31, 2022, based on your account balance on December 31, 2021.

If you're still employed by the plan sponsor of a 401(k) and are not considered to be a more than 5% owner, your plan may allow you to delay RMDs until you retire. The delay in starting RMDs does not extend to owners of traditional IRAs, Simplified Employee Pensions (SEPs), Savings Incentive Match Plans for Employees (SIMPLEs) and SARSEP IRA plans.

One more twist…

In November of 2020, the IRS announced the update of the life expectancy tables that are used to calculate the annual amount of RMDs. This change brings the tables more in line with the fact that Americans are living longer than assumed in previous calculations. The finalized rules related to the updated tables will apply to distributions in calendar years beginning on or after January 1, 2022.

It's crucial that account owners become familiar with the changes in the rules pertaining to RMDs. Mistakes can be costly: The IRS assesses a 50% federal penalty tax on the amount of the RMD that should have been taken but wasn't. So, working with your tax consultants and plan's service providers is important when making decisions regarding RMDs.

Upcoming Compliance Deadlines for Calendar-Year Plans

January 31st

IRS Form 1099-R - Deadline to distribute Form 1099-R to participants and beneficiaries who received a distribution or a deemed distribution during the prior plan year.

IRS Form 945 - Deadline to file IRS Form 945 to report income tax withheld from qualified plan distributions made during the prior plan year. The deadline may be extended to February 10th if taxes were deposited on time during the prior plan year.

February 28th

IRS Form 1099-R Copy A - Deadline to submit 1099-R Copy A to the IRS for participants and beneficiaries who received a distribution or a deemed distribution during the prior plan year. This deadline applies to scannable paper filings. For electronic filings, the due date is March 31, 2022.

March 15th

ADP/ACP Corrections - Deadline for processing corrective distributions for failed ADP/ACP tests without a 10% excise tax for plans without an Eligible Automatic Contribution Arrangement (EACA).

Employer Contributions - Deadline for contributing employer contributions for amounts to be deducted on 2021 S-corporation and partnership returns for filers with a calendar fiscal year (unless extended).

April 1st

Required Minimum Distributions - Normal deadline to distribute a required minimum distribution (RMD) for participants who attained age 72 during 2021 (and didn't reach age 70 ½ in 2019).

April 15th

Excess Deferral Correction - Deadline to distribute salary deferral contributions plus related earnings to any participants who exceeded the IRS 402(g) limit on salary deferrals. The limits for 2021 were $19,500 or $26,000 for those age 50 and over if the plan allowed for catch-up contributions.

Employer Contributions - Deadline for contributing employer contributions for amounts to be deducted on 2021 C-corporation and sole proprietor returns for filers with a calendar fiscal year (unless extended).

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