Flashpoint: All the Guidance That's Fit to Print: Gifts from the DOL and IRS (Gee, We Didn't Get Them Anything!)

In the last few weeks, the U.S. Department of Labor ("DOL") and Internal Revenue Service ("IRS") have published a number of key items of guidance. Ranging from Pooled Plan Provider ("PPP") registrations and lifetime income illustrations to rollover rules for qualified plan loan offsets, the materials are vast and welcome by many in this industry. Please forgive the length of this FlashPoint as we try to bring you up to date.

Welcome PEPs

The first step for any Pooled Employer Plan ("PEP") —the new multiple employer plan option that was created by the Setting Every Community Up for Retirement Enhancement ("SECURE") Act—is to have an entity agree to serve as the PPP. SECURE requires that every PPP register with both the DOL and IRS. Based on the Notice of Proposed Rulemaking ("NPRM") issued on August 20, 2020, it appears that the DOL and IRS have agreed to play nice and jointly require only one registration application. Huzzah!

Initial PPP Notice. The initial PPP registration must be done 30 to 90 days before the PPP intends to begin marketing a PEP or marketing itself as a PPP. The key idea is to have the registration information available to anyone who is interested before s/he decides to get involved with the PEP. This means that, if a PPP wants to begin marketing a PEP as of January 1, 2021, the PPP will need to file the registration by December 2, 2020, which does not leave the DOL a lot of time to finalize the regulation and get the registration process on-line.

The NPRM provides a mock-up of the application, Form PR, and notes the intent to require PPPs to file Form PR electronically through EFAST2. Both the DOL and IRS, as well as the public, will have access to the data on Form PR.

The initial filing will identify the PPP's name, contact information, and other organizational information, such as the PPP's address and phone number and the identities of the chief executive officer, the individual responsible for ERISA compliance, and the agent for service of legal process. In addition, the filing would include a listing of services that the PPP intends to offer to the PEPs it sponsors. The filing also requires with some specificity any information about any history of federal or state criminal convictions or ongoing administrative proceedings of the PPP or its officers, directors, or employees relating to employee benefit plans.

Generally, only one Form PR is required, even if the PPP operates several PEPs.

Supplemental PPP Notice. A Supplemental Form PR will also be required within 30 days of certain changes to the original filing or upon the occurrence of specified events that "may signal financial problems or other circumstances that could potentially put the pensions of covered employees at risk." These events include:

- The actual initiation of operations of a PEP (including the original and any additional PEPs);
- Within 30 days after the following changes in circumstances:
  - A significant change in the corporate or business structure of the PPP, such as a merger or acquisition;
  - The initiation of bankruptcy, receivership, or other insolvency proceeding for the PPP or its affiliate; or
  - The receipt of written notice of (i) any administrative or enforcement action in any court or administrative tribunal by any federal or state governmental agency related to the operation of the PEP; (ii) a finding of fraud or dishonesty by a federal or state court or agency related to the operation of the PEP; or (iii) the filing of any federal or state criminal charges related to the operation of the PEP *or other employee benefit plan.*

Final PPP Supplemental Filing. As with everything in life, there needs to be an endpoint. When the PPP has ceased operating <u>all</u> PEPs it operates, a final Form PR must be submitted within 30 days of the filing of the final Form 5500 for the last PEP.

All registration requirements will be found at Labor Regulation § 2510.3-44.

The DOL is uncertain as to how many potential PEPs may be created once these regulations are finalized, but it is confident that some folks will be ready to jump into the pool. We have had several clients express interest in MEPs and PEPs in the past several months.

For further background on PEPs and MEPs, as well as the SECURE rules for maintaining a PEP, see our prior FlashPoints: *New Pension Legislation Passes! Feeling More Secure?* and *SEP, MEP, or PEP*.

<u>**What Is a Lifetime of Savings Really Worth?**</u>

That is the question that the DOL hopes to answer for defined contribution participants. On August 18, 2020, the DOL issued the Interim Final Regulations ("IFR") on the Lifetime Income Illustrations ("LII") mandated by the SECURE Act. [Labor Reg. §2520.105-3] ("Interim Final Regulation" always seems like such a strange name. How something can be "final," and yet only "interim," seems to be a contradiction in terms … sort of like "temporary permanent"! But, we digress …)

The LII concept is driven, in part, by statistics showing that very few Americans have enough financial savvy to reasonably convert their defined contribution account balances to a monthly retirement income. (For example, studies show that only 25% of those between the ages of 60 and 75 can pass a basic retirement literacy test.) The DOL hopes that providing such a conversion will help people understand whether their current savings level is sufficient and, if not, make adjustments before it's too late.

The new rules are effective for statements issued more than one year from the date on which the IFR appears in the Federal Register. Assuming publication this month, it is likely that the statements for the September 30, 2021, plan year ends will need to include the required information. (Presumably, by then, the DOL will have issued the final regulation, which should take into consideration public comments.) Note that these LIIs must be included on participant statements only once annually; but the employer or recordkeeper may include the information on each quarterly statement if it wants to avoid having to generate multiple statement templates.

What Needs to Be Illustrated

Once per year, a defined contribution plan must show for each participant the value of his or her account balance, expressed as a life annuity and a 100% joint and survivor annuity. The illustration must assume that the participant is currently age 67, is married, and that the spouse (for the J&S) is the same age as the participant.

The assumptions that must be used to convert the account balance to the annuity payments are: (a) interest: the 10-year constant maturity Treasury securities yield rate for the first business day of the last month of the statement period; and (b) mortality: the Internal Revenue Code §417(e)(3)(B) unisex table. There is no inflation adjustment. If there is a participant loan, its balance should count in the projected account unless the loan is in default. (In case some of you are curious, if the LII were implemented for August 2020, the interest rate to be used would be .56%.) Both the assumed interest and the mortality table are commonly published.

What Does This Thing Look Like?

The DOL provided a sample of what the pension benefit statement might look like:

Account Balance as of [DATE]	Monthly Payment at age 67 (Single Life Annuity)	Monthly Payment at 67 (Qualified Joint and 100% Survivor Annuity)
$125,000	$645/month for life of participant	$533/month for life of participant $533/month for life of participant's surviving spouse

In addition to the table shown above, the participant statement must include explanations outlined in the IFR about what the assumptions are and what they mean—**11** explanations in all. The DOL provides model language for these explanations. There are different explanations if the plan actually permits the purchase of annuities or if there are already deferred annuities as part of the participant's account. A quick examination of this model language will reveal that the DOL has the same problem drafting language that is understandable to the average participant as we all do. For example, a participant is advised in the model language that, "the estimated monthly payments in this statement are based on prevailing market conditions and other assumptions required under federal regulations." (For those of you still trying to get your disclosures to have a Flesch reading score below high school level, this phrase requires you to be in grade 19.7—that is, in graduate school—and can be understood by about 8% of the population.)

If the assumptions follow DOL rules and the explanations are either identical to or "substantially similar" to the DOL model language, no plan fiduciary, plan sponsor, or "other person" will be liable under ERISA for anything related to providing this information. Needless to say, it makes sense to just use the model language to avoid any possible liability.

It is easy to see that the numbers to be included in the participant statements are likely to have very little relationship to what a participant actually receives. In short, they are based on the current value (with no projection to the participant's actual retirement) and the annuity conversion has no relationship to the participant's current or projected retirement age or actual marital status. Therefore, their main value is to provide some general guidance about the conversion of lump sums to annuities, coupled with a comparison value from year to year. The information will grow in relevance (and accuracy) as a participant nears retirement age.

Understanding the Assumptions Chosen by the DOL

The DOL's preamble to the IFR explains in some detail why they chose these assumptions. The reasons are generally a mixture of seeking simplicity (in particular, avoiding the plan administrator needing to collect marital information and spousal dates of birth) and uniformity. While the wisdom of these choices may be questionable, it certainly reduces the burden on administrators and recordkeepers and should make generating this information very simple.

The DOL continues to encourage information above and beyond the simplistic illustration required by the IFR, such as interactive models that are customized based on the input from the participant. These dynamic models are likely more relevant and superior to the mandatory illustration for participant use. However, they do not exempt a service provider from providing the required disclosure, nor will they be covered by the liability limitation of the IFR. So, you get points for innovation, but it doesn't meet the LII requirement.

Anyone who feels strongly about the IFR can share feedback with the DOL on any or all parts. The comment period ends 60 days from the date on which the IFR is published in the Federal Register (which has not yet occurred).

SECURE Act Clarifications

On September 2, 2020, the IRS released Notice 2020-68 (the "Notice"), which clarifies certain SECURE Act provisions. The Notice is intended to help plan sponsors implement these new benefits and answer some of the burning questions we've had since SECURE was enacted.

EACA Implementation Tax Credit – Spoiler Alert!

The IRS confirmed that employers participating in a multiple employer plan ("MEP") whose participants are subject to an EACA are eligible for a $500 tax credit for each year during a three-year period, beginning in 2020. The IRS also made it clear that there is no double-dipping. So, an employer that gets to enjoy this three-year credit can't hokey-pokey the EACA provision in and out to take the credit twice. An employer that adopted an EACA in 2018 would be eligible for the credit in 2020 (the third year after adoption), and would not be eligible in any future year.

The Notice does not discuss the $5,000 plan start-up tax credit available to any small employer that adopts a plan. However, as the definition of “eligible employer” for purposes of the EACA tax credit is the same as for the start-up credit, it would appear that employers that newly adopt into a MEP will also be eligible for this credit.

Long-term, Part-time Employees

SECURE requires 401(k) sponsors to allow long-term part-time employees (“LTPT”) to defer. LTPTs are employees who have never had a year of service (i.e., a year with 1,000 hours of service) but who have worked at least 500 hours of service during each of three consecutive years. Service for LTPT employees does not need to be counted for eligibility periods beginning before January 1, 2021. So, suppose Amy had 550 hours of service every year from 2018 to 2024. Amy’s three consecutive years would be 2021, 2022, and 2023, and she would enter the plan under the LTPT rules in 2024.

The plan does not have to provide employer contributions for LTPT employees, but, if it does, a special vesting rule applies. The employee is credited with a year of service for vesting purposes for each year with at least 500 hours of service. The employee keeps those vesting credits even if s/he later completes 1,000 hours in a year. The Notice clarified that all service with the employer will count for purposes of determining vesting. In our example, the plan must credit Amy with a year of vesting service for every year beginning in 2018, so that she has six years of service when she enters the plan, making her fully vested.

Qualified Birth or Adoption Distributions (“QBADs”)

If an employer elects to permit these distributions in the plan, and an individual has multiple births or adoptions, he or she may request multiple distributions. For example, if an employee has twins, s/he is eligible to receive a $10,000 distribution, instead of the standard $5,000 amount. (So, Octo-Mom could receive $40,000. Wow!) If both parents participate in retirement plans, each can receive $5,000 per child. The plan can rely on a participant’s representation that he or she is eligible for a QBAD.

Also, if the plan does not permit QBADs, but the employee qualifies for another distribution, s/he may take the distribution and still enjoy the benefits of the waiver of the 10% additional tax under Code §72(t)(1). Recontribution in this instance, however, would have to be done to an IRA instead of the plan.

Amendments to Permit In-Service Withdrawals from Defined Benefit Plan at Age 59½

The legislative package that included SECURE, the Further Consolidated Amendments Act, also included the Bipartisan American Miners Act of 2019 (the “Miners Act”). It was this section of the legislation that contained the ability of defined benefit and money purchase plan sponsors to amend their plans to permit in-service distributions at age 59½, rather than age 62. However, the extended amendment period available under SECURE (which permits amendments up until the last day of the 2022 plan year) was not part of the Miners Act, thereby requiring amendments by the end of the plan year in which they are effective.

The Notice modified the amendment deadline to match the SECURE amendment rules. Therefore, an amendment to change the in-service distribution rules in a pension plan may be adopted by the last day of the 2022 plan year and be effective retroactively to the first day of the 2020 plan year. Special deadlines apply to collectively bargained plans and governmental plans. The plan must be operated in accordance with the ultimate amendment during the interim period.

IRA Guidance

The Notice also contains information about IRA contributions after age 70½ and nondeductible IRA contributions. If you are interested, check it out.

Qualified Plan Loan Offsets ("QPLOs")

We have a new fun acronym to say – QPLO! QPLOs are originally a gift from the Tax Cuts and Jobs Act ("TCJA"), and are discussed in Code § 402(c)(3)(C)(ii). For those of you who can't remember back to 2017, TCJA (not an acronym that rolls off one's tongue) permitted employees who experienced certain loan offsets to repay those loans to an IRA any time before their tax return due date (including extensions) for the year of offset, and to treat those loans as a nontaxable rollover. To qualify, the loan had to be treated as an offset due to either termination of the plan or the employee's failure to make repayments due to his or her severance from employment. Thus, instead of being hit with potentially awful taxes, and losing the benefit of the funds for retirement, the day can be saved if the employee can scrabble the money together by Tax Day.

Treasury issued proposed regulations on QPLOs in new § 1.402(c)-3. Taxpayers can rely on these rules before they are finalized. These proposed regulations outline the fine points of the above rules and give multiple examples. No real surprises here, but the details may be helpful. For example, the regulations clarify that a loan offset is considered to be "on account of" the employee's termination of employment if it occurs within a year of the employee's termination and relates to a failure to make payments as required under the loan terms during that time. Furthermore, it provides that the loan may not be in default at the time of severance to be a QPLO. The default must occur after termination. Finally, the regulations remind us that, even if the loan offset is not a QPLO, it may still be rolled over during the normal 60-day period if the participant has the financial resources to do so.

Can a participant file his or her taxes timely and still roll over the QPLO by the extended return due date, even if s/he did not apply for an extension? Yes! Under the handy-dandy extension rules of Treasury Reg. § 301.9100-2(b), participants get an automatic six-month extension to fund the repayment of the QPLO after the unextended tax return due date, provided that (i) the individual's return was filed timely for the year the election should have been made; and (ii) the individual makes the necessary deposit within that six-month extension period. In other words, the employee will have 9½ months after the end of the plan year in which s/he receives a loan offset to get the amount redeposited to an IRA, even if the employee chooses not to file for a tax extension.

Here's the danger of filing taxes timely in anticipation of repayment within the six-month extension period. Let's say Joe Taxpayer was laid off from his job in June 2020, and ends up with a loan offset. When it comes time to pay his taxes in April 2021, Joe is feeling really confident that he can repay the loan offset amount by October 15, 2021. But, when that time comes, either Joe can't come up with the money or simply forgets about it. Now, Joe has an understated tax return, which could lead to a love letter from the IRS (with the application of interest and perhaps underpayment penalties) or, even worse, an up-close and personal visit from an IRS auditor. It is probably better to just file the extension and know the score before the tax return is filed.

This guidance, published August 20, 2020, also provides coding information for Form 1099-R. For a plan loan offset amount, an administrator would normally use a Code L for deemed distribution in box 7. If the transaction will be a QPLO, the coding changes to a Code M in box 7. The instructions to the 2020 Form 1099R clarify that the Code M attests to the fact that the loan was due to the termination of the plan or the participant's loan default as a result of his or her termination of employment. In other words, whether the participant actually completes the rollover is not relevant to this coding.

It's All Downhill from Here

As September 30 approaches and the federal agencies come to the end of the federal fiscal year, we can expect more guidance to be released in the coming weeks. With December 31 only a scant few months away and new things coming in 2021, you can clean off those reading glasses. If the past prolific nine months are any indication, there is much more to come!

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