Flashpoint: The Special MEP Unified Plan Rule- Kicking Out the Rotten Apple After SECURE

On March 25, 2022, the Department of the Treasury released new proposed regulations in relation to the special application of the Unified Plan Rule to certain multiple employer plans ("MEPs"). Treasury attempted to address this issue prior to the enactment of the Setting Every Community Up for Retirement Enhancement ("SECURE") Act of 2019. However, the issue became even more relevant (and perhaps more complex) due to changes to the statute under SECURE.

The Unified Plan Rule (the "Rule"), sometimes called the "one bad apple rule," provides that, if any part of a plan fails to meet the qualification requirements of the Internal Revenue Code (the "Code"), the entire plan is subject to disqualification. In a MEP context, however, the Rule means that one noncompliant employer can put the benefits of all adopting employers' participants at risk for unfavorable tax treatment. Therefore, the IRS proposed rules under which the MEP could preserve its qualification as to the "innocent" employers and their participants if action were taken to jettison the noncompliant employer and the benefits of its employees from the MEP. (See our ***FlashPoint*** from when these regulations were proposed.)

Under SECURE, Congress enacted Code Section 413(e), which relieves plans that are recognized as multiple employer plans by the Department of Labor ("DOL") or that have a Pooled Plan Provider ("PPP") (generally, Pooled Employer Plans ("PEPs")) from the Rule. The part of such plan relating to the compliant employers is protected from disqualification. The statute set up a set of broad parameters, with the promise of regulations to flesh out the details.

The new proposed regulations (the "Proposal"), if finalized, provide considerable "fleshing out" of Section 413(e). The Proposal is procedural in nature, outlining that the Plan Administrator of the MEP ("MEP PA") is required to provide a series of up to three notices to the noncompliant employer (called the "Unresponsive Participating Employer" or "UPE"), leading to the ultimate expulsion of the UPE from the MEP.

Open MEPs are Still Outcast

Both the statute and the Proposal continue to offer this treatment only to defined contribution MEPs that either have a registered PPP acting as the named fiduciary and plan administrator, or are maintained by employers that all have a common interest other than having adopted the plan.

In particular, MEPs sponsored by service providers that are not PEPs and which lack that commonality, commonly referred to as "Open MEPs," are not eligible to use these special rules, and remain vulnerable to the Unified Plan Rule.

The Procedure for Dealing with UPEs

The Proposal requires that the MEP be amended to include language authorizing the MEP PA to carry out a series of steps intended to encourage compliance by the UPE or, failing that, to boot it out of the program to protect the balance of the plan.

There are two types of UPEs: those that do not respond to demands for information (such as an employer that fails to submit census information), and those that do not act when required to do so (such as an employer that will not deposit safe harbor contributions). It is possible that a UPE can correct a failure to provide information and promptly find itself with a failure to act when the provided information demonstrates noncompliance with qualification requirements. This is akin to going from the frying pan into the fire, leaving the employer with a still noncompliant portion of the MEP.

You've Been Warned: First Notice

The MEP PA's first notice must outline the UPE's failure and the actions that the UPE must take to correct the failure (i.e., the fix). The UPE always has the option of initiating a spinoff of its portion of the MEP to a single employer plan outside the MEP (and this option can be used anytime during the process). The notice must then provide that, in absence of either the fix or the spinoff by the UPE, the MEP PA will stop receiving contributions from the UPE and its employees, and the UPE and the parties responsible for its noncompliance will be subject to adverse tax consequences. Finally, the notice will provide the UPE with 60 days to act.

I'm Not Kidding: Second Notice

If the UPE takes no action to fix or spin off, the MEP PA must issue a second notice within 30 days of the expiration of the 60-day period. This notice must contain all the information from the first notice, plus a warning that the third notice, if made necessary, will also be sent to the participants and the DOL

Okay, Now I'm Telling Mom: Third Notice

If the UPE still fails to act, the MEP PA must issue the third and final notice within 30 days of the end of the second 60-day period. That notice is sent to the UPE, the participants, and the DOL. It must repeat everything in the first notice, note that the participants and the DOL are also recipients of the notice, and give a final deadline for the fix or for initiating a spinoff. Sixty days after this notice, the jig is up, and the MEP PA must take final action.

At any time during this process, the UPE can stop the process by doing what the MEP PA needs it to do. Of course, if the problem is a failure to act, corrective action under the Employee Plans Compliance Resolution System ("EPCRS") may be required, as well. The Preamble to the Proposal discusses that coordination of Code 413(e) with EPCRS is needed.

The Proposal also notes that a failure of the MEP PA to provide the notices on a timely basis, when the document will require such action (see notes below regarding plan amendments), will constitute an operational failure under EPCRS.

The UPE Never Cooperates … Now What?

At the end of the three-notice process, if the UPE never fixes the failure or requests a spinoff, the MEP PA begins the process of jettisoning the UPE from the plan. First and foremost, the MEP PA must stop accepting either employer or employee contributions in relation to the UPE's participants.

Second, all such accounts must become fully vested. The Proposal does not distinguish between accounts of active employees and terminees. So, apparently, all accounts are vested, regardless of the participant's status, just as they would be in a terminated plan.

Under the original proposed regulations, the MEP PA was able to spin off the portion of the plan attributable to the UPE to a single employer plan sponsored by the UPE. There were many unanswered questions about how this was to be done, but those questions are no longer relevant. Under the Proposal, the only spinoff that may happen is one that is initiated by the UPE. In absence of this action, the MEP PA must give all the affected participants and beneficiaries a choice: (a) direct a rollover to an eligible plan; or (b) leave the account in the MEP. If no election is made, the default is to leave the account in the MEP, where it is distributed in accordance with the MEP terms. Because the MEP PA may not remain in touch with the UPE, the MEP PA can take the participant's representation as to a severance from service (and, therefore, eligibility for a distribution) in absence of contrary actual knowledge.

If the UPE decides to authorize a spinoff, the MEP PA must complete the spinoff as soon as practicable, but within 180 days. Any prior UPE failure to act that constitutes a qualification failure follows to the new spinoff plan, tainting it from the start. Presumably, the UPE will be able to correct that issue under EPCRS, but as the failure occurred in the MEP, it is not currently clear how this would be done. (We assume that will be dealt with in the IRS's coordination of EPCRS with the Proposal.) In absence of correction, however, the Proposal specifies that the IRS can take any action against the individuals responsible for the noncompliance, including denying favorable tax treatment to their plan accounts.

Nonetheless, it seems odd that the Proposal requires the MEP fiduciaries to effect the spinoff of the UPE's participants' accounts to a plan controlled by the UPE, notwithstanding the UPE's historic unwillingness or inability to keep its part of the MEP in compliance with the Code. One must assume that these accounts are more at risk outside the MEP for both disqualification and misuse by the UPE than they were inside the MEP. Doesn't this rule put the innocent participants' accounts in a position of potential harm? And how is this consistent with the MEP fiduciaries' duty to the participants? This must be addressed by the DOL in the future.

A Few More Comments …

The notices under the Proposal may be provided in paper or electronically, and the Treasury points to its regulations in Section 1.401(a)-21 as the governing rules for electronic delivery.

The Proposal permits something that the earlier proposed regulations did not: reliance until the regulations are finalized. Following the Proposal is deemed to be good faith compliance with Code Section 413(e) until the final rules come along.

The Proposal shortens the notice periods from the original proposed regulations, which provided 90 days in between each notice for the UPE to act. While the total process under the Proposal

still takes at least 6 months (assuming that the next notice is given immediately upon expiration of the waiting period), that is a 33% reduction over the prior 9-month stretch.

As noted above, the Proposal makes it clear that the MEP document must contain language permitting the procedures. However, the model language that Treasury has promised is not yet available (and probably won't be available until the regulation is finalized). So, a few questions arise. First, if the MEP chooses to take advantage of the available procedure to oust a UPE, must it be amended (to the best of the drafter's ability) before it can do so? Is the plan in "good faith compliance" if the amendment is not done? And, is there a remedial amendment period after the use of the Proposal procedures to correct this form failure (such as the SECURE amendment deadline of December 31, 2022) that would allow such a MEP PA to wait for the model language? Second, does the MEP PA have any *contractual* authority to take action against the UPE in absence of the language being in the MEP (and perhaps the UPE being given notice of such addition to the plan)? Finally, if your MEP was drafted to include language intended to comply in good faith with SECURE, will using the Proposal's procedure without amending out that language create a failure to follow the plan terms? Making a stab at a good faith amendment to conform to the Proposal may be the safest route in absence of further guidance.

And, lastly, exactly how EPCRS will apply to both the MEP (and, presumably, the UPE spinoff plan) is yet to be determined. The preamble to the original proposed regulations contained assurances that the MEP would not be considered to be "under examination" (and, therefore, potentially eligible for self-correction or VCP) so long as the IRS review of the MEP was initiated after the first notice was issued. The Proposal, on the other hand, only assures the MEP PA and the UPE that a failure to take action is considered to be resolved when the UPE makes the fix and the plan satisfies the requirements of EPCRS as to the underlying failure. Absent clear rules, perhaps the IRS will be flexible in its examination process as to this issue.

Conclusion

In the end, the Proposal, which provides guidance on a relatively short section of SECURE, gives a roadmap to how to deal with a noncompliant participating employer. While the details are a little murky in relation to both documentation and EPCRS compliance, it likely gives sufficient direction to allow the MEP PA to at least start the process of good faith compliance.

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