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It's the End of the Year as We Know It: Preparing for the End of the Plan Year, Calendar Year, and Next Year

By Adrienne I. Moore, Esq.

It is January 15, 2020. Evangeline was recently hired by Acadia International as Director for Human Resources. Although she has prior experience with health plans, she is relatively new to retirement plans. Acadia sponsors a calendar year 401(k) profit sharing plan with a basic safe harbor matching contribution. Over the next month before the current HR director retires, Evangeline is put through her paces as she provides information to the accounting department for preparation of Forms 1099-R, uploads participant information to the plan recordkeeper for new deferral elections, and compiles new hire data into a census file for the third party administrator ("TPA"). By mid-February, Evangeline stops to take a breath, assured by her predecessor that the busiest plan time is behind her. "Good," she thinks. "How much worse could things get?"

One physical year and an emotional century later, it is November 2020. Evangeline has attended every webinar she can find about retirement plans and has spoken to the Plan's TPA every other week since mid-March. Her efforts have helped keep Acadia and its employees afloat during the worst of 2020. The Plan's participants have taken coronavirus-related distributions ("CRDs") that Acadia decided to offer, and, in July, Acadia avoided the layoffs that its CFO thought were necessary by deciding instead to suspend its safe harbor contribution. Things are finally looking up. However, as Evangeline returns to the office after Thanksgiving, she starts receiving a bunch of items in the mail from the Plan's TPA and recordkeeper. First, it's a safe harbor notice. Then, it's a qualified default investment alternative notice. Next, it's an authorization for administration fees to be paid from an ERISA Account (whatever that is). Evangeline knows enough now to realize that timing is a key factor in plan operations. What is she supposed to do with all this stuff, and what else does she need to do to finish the year strong and start 2021 off on the right foot?

Plan Requirements Can Arise at Many Times During the Year … Sometimes Unexpectedly

Generally, retirement plans have compliance requirements that must be met annually (e.g., filing of the annual report or distribution of a safe harbor notice), quarterly (e.g., distribution of participant benefit statements in a plan with participant-directed investments), or when some event happens (e.g., when an employee first becomes eligible or if the plan changes custodian, which causes a trading blackout for a few days). The end of the plan year tends to be a busy

time for administration, as plan sponsors and service providers work to ensure that all requirements are met before another plan year has ticked away.

Annual Plan Requirements

Census and Eligibility Tracking

The Acadia Plan requires employees to attain age 21 and complete 1,000 hours of service in a 12-month period to be eligible to participate. Entry dates occur semi-annually on January 1 and July 1. Administratively, this means that Evangeline should expect some employees will first become eligible to participate in the Plan on January 1, 2021. To effect this participation, she will need to identify newly eligible employees before the plan year end and provide them with enrollment materials. Many other notices need to be provided to participants at least 30 days prior to the plan year end. Evangeline probably wants to identify her new entrants early enough to send enrollment materials to these employees at the same time that she is sending other annual plan notices that are due before January 1.

Participant-Directed Investments

All investments in all accounts in the Acadia Plan are participant-directed. The Plan is intended to comply with the requirements of ERISA Section 404(c) and provides for a qualified default investment alternative ("QDIA"), in which participants' accounts are invested if they fail to make their own investment elections. The Plan, then, must provide two notices related to these investment decisions. First, the 404a-5 disclosure, which advises participants about the performance and fees of investment options in the Plan and possible other fees to be charged to their accounts, must be sent annually. (Note that participants must also receive quarterly disclosures reflecting just the fees that were actually charged to their accounts. From a practical standpoint, many recordkeepers choose to distribute the full 404a-5 disclosure quarterly to participants, rather than maintain two separate disclosures with different timing requirements.) Second, the QDIA notice must be sent at least 30 days before each new plan year (or to an employee at least 30 days before that employee becomes eligible to participate). Evangeline will need to send the QDIA notice to all participants and newly eligible employees by December 1 and should ensure that one of the Plan's service providers is preparing the 404a-5 disclosure for her to send.

Safe Harbor Plans

The Acadia Plan provides for a basic safe harbor matching contribution. However, it was suspended in July 2020 due to the COVID-induced business hardship. Acadia's financial situation has improved and Henry, Acadia's owner, sends Evangeline a message asking whether the match can be reinstated for 2020 after all? The answer is no. Even with certain legislative changes (discussed in more detail below), once a safe harbor matching contribution is suspended for a year, it cannot be reinstated for that year. (This in-and-out may be possible for a nonelective safe harbor plan, but that is not the situation with Acadia.)

Henry then asks whether they can take advantage of the late adoption rules to instead implement a 3% safe harbor nonelective contribution before the end of 2020. This is also not permitted when a plan maintained a safe harbor match anytime during the year. Evangeline advises Henry that 2020 is a "done deal" – but they should provide the annual safe harbor notice by December 1, 2020 (i.e., no later than 30 days before the plan year-end) if they are sure that they want to reinstate the safe harbor match for the 2021 plan year. Furthermore, if there is any doubt that they will be able to fund the full match, it is a good idea for that notice to include language outlining

that the match could be suspended during 2021 if Acadia determines it is necessary (often referred to as a "maybe not" notice). This additional language would allow the mid-year suspension of the match even if there is not a substantial business hardship, keeping this option open if needed. If we learned anything from 2020, it is to hedge our bets when possible.

Automatic Enrollment Notices

Automatic enrollment is when 401(k) plans provide that all participants will have elective deferrals equal to a specified rate unless they affirmatively elect a different rate (which may include no deferrals at all).

Plans that provide automatic enrollment must notify participants that this will happen (and the rate of contribution that will be applied) and of their opportunity to elect otherwise. All automatic enrollment plans must provide annual notice to their participants a reasonable time before the beginning of the plan year. This has been interpreted to mean at least 30 days in advance of the plan year, or no later than December 1 for a calendar year plan.

Plans must also provide notices to new entrants before they first become affected by automatic enrollment. The rules about notices vary depending on the type of automatic enrollment provision; check with your third party administrator or recordkeeper if you have questions.

Administratively, then, if the Acadia Plan provides an automatic enrollment feature, Evangeline will need to provide notice to participants by December 1 each year, with special timing to apply to employees who become eligible to enter the Plan during the year. (The more entry dates there are in a year, the more often during the year someone may be due an automatic enrollment notice.)

Forfeiture and ERISA Accounts

The Acadia Plan allows for employee elective deferrals and historically has made only safe harbor basic matching contributions (which are both always fully vested). As a result, there are no forfeited amounts in the Plan. However, if a plan has forfeitures, the plan document may provide that these forfeitures are: (a) used to pay plan expenses; (b) used to fund employer contributions; or (c) allocated to participants as additional amounts.

Still, the Plan's custodian maintains an ERISA Account for the Plan, into which certain revenue payments are placed until used by the Plan Administrator. The assets in the ERISA Account may be used to pay plan expenses, including service provider fees. Both ERISA Accounts and forfeiture accounts usually must be spent in full annually.

Evangeline needs to work with Henry to determine how the amounts in the ERISA Account will be used. Governing federal agencies understand that, as the bulk of the plan year's administration will often occur in the first quarter of the following year, administrative expenses for 2020 may not come due until March or April in 2021. As such, Evangeline may hold back a reasonable amount in the ERISA Account to cover the expected administrative expenses for the 2020 plan year until they are due, even though it is after the end of the plan year, without causing a violation. To determine a reasonable amount of fees, Evangeline should review the service agreements for the plan service providers, review prior invoices, or reach out to the plan service providers for estimates.

*Note: A summary of these items can be found on the End of Year Checklist **here**.*

Special 2020 Considerations

As illustrated above, the period before a new plan year is always a little challenging. Needless to say, the end of 2020 is a whole other story! 2020 has presented unbelievably unique challenges. (Look: I didn't use the other "u" word. You know, "Unprecedented.") The Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"), passed in March 2020, has provided us with some solutions to COVID-related problems, as well as several new twists to our usual operations. Some plans, like Acadia's, may have allowed participants to take CRDs. For others, participant loan repayments may have been temporarily suspended.

As if that were not enough, you may recall that the Setting Every Community Up for Retirement Enhancement Act (the "SECURE Act") passed at the end of 2019, has many new provisions effective either in 2020 or as of January 1, 2021. So, as 2020 ends, we not only have to deal with the trailing end of the CARES changes, but also those relating to SECURE. As the year that will not end is finally winding down, plan administrators will need to review this substantial legislation and ensure they have addressed both the new legal requirements and options that either were adopted over the past year or that may be important in the year to come.

(For detailed information on this legislation, please see our Flashpoints on the SECURE Act and the CARES Act **here**.)

Here is a summary of some of the things about which you need to be concerned if you took advantage of any of the CARES relief provisions.

Coronavirus-Related Distributions

The CARES Act allowed plans to permit participants to take CRDs if they were qualified individuals. Except for defined benefit or cash balance plans (or tax-exempt 457 plans), a plan sponsor could amend its plan to permit a CRD to be taken even if the participant would not normally be eligible for a distribution. In addition, the participant has three possible tax advantages available for a CRD: (1) CRDs are exempt from the 10% additional tax that usually applies to distributions to participants who are under age 59½; (2) CRDs may be taxed over a three-year period rather than all in 2020, so that the tax rate is potentially lower; and (3) participants may repay all or part of a CRD to a plan or IRA during the three-year period following the distribution to avoid taxation altogether. So, this raises at least three questions: How does a plan sponsor report the distribution to ensure the IRS will be aware it is a CRD? Does the plan need to be amended if it allowed CRDs? Finally, what happens if a participant takes advantage of the ability to repay the CRD to the plan?

Evangeline processed one CRD for Gabriel in June, who was already working from home when he was infected with COVID. Gabriel self-certified to Evangeline that he was a qualified individual. This self-certification is permissible under CARES, and Evangeline treated the self-certification of his qualified individual status the same way she would a self-certified hardship distribution request. As Evangeline prepares for the end of the year, she will need to ensure the Form 1099-R reporting the CRD is prepared correctly. Forms 1099-R are prepared on a calendar year basis and must be sent to participants by January 31 of the year following the year of distribution. If the plan year is a calendar year, it is best to address them as part of your end of year planning.

Because Gabriel would not have normally been able to take a distribution from the Plan but for CARES, Acadia must amend the Plan to allow CRDs. Otherwise, such distributions would be considered to violate the Plan's terms. Evangeline authorizes the TPA to prepare an amendment

to the Plan for this purpose. The amendment must be adopted by the end of 2022, so there is plenty of time.

In addition, Evangeline must know now how to report the distribution on the Form 1099-R due in January. In Evangeline's case, one participant is involved and she is intimately familiar with the details of the distribution. Working this out with her TPA and recordkeeper will not be difficult. For other employers, the situation may not be so simple.

If plans permitted special CRDs and got certifications from their employees, the Forms 1099-R can be prepared to reflect them as exempt from the pre-age 59½ penalty (Code 2). Participants who are qualified individuals may be eligible to treat their distributions as CRDs even if the plan treated them as taking normal distributions. In that situation, the employer may not know that a distribution qualifies as a CRD. How can the employer prepare Forms 1099-R under those circumstances? The IRS permits the plan to issue Forms 1099-R without noting the special exemption from the pre-age 59½ tax (i.e., using Code 1). The participant will be able to claim the CRD tax benefits by filing a Form 8915-E with his or her own tax return.

Luckily for Gabriel, his health and financial situation improved by the end of the year, and he inquired with Evangeline about repaying his entire CRD in December. The IRS has indicated that plans that accept rollover contributions should accept CRD repayments. It follows that CRD repayments should be treated as rollover contributions. Evangeline will allocate the funds to Gabriel's rollover account in the Plan. The repayment, however, does not alter the Plan's Form 1099-R filing for the amount distributed.

Gabriel, as well as any other participant who repays a CRD within three years of the distribution, will need to file a Form 8915-E to reflect the repayment. Special rules apply – often requiring an amended Form 1040 – if the repayment of the distribution occurs in years after the 2020 tax return is filed.

Loan Payment Suspension

As with CRDs, some plan sponsors have allowed participants to suspend loan repayments during 2020 pursuant to CARES. The effect of CARES was a suspension only and not a loan forgiveness. Therefore, interest continues to accrue on the loan principal during the suspension and the participant eventually needs to repay the loan. Such loans may present one of the trickier administrative hurdles, as loan payments will need to re-start in January 2021.

Assume Gabriel had a participant loan and suspended his loan payments between June 2020, when he was infected with COVID, and the end of 2020. To successfully re-start payments on the loan, Evangeline will need to determine the outstanding loan value (adjusted for the accrual of additional interest between June 2020 and January 2021), identify the date on which repayments will need to begin (i.e., the first pay date in 2021), determine the new extended due date for the loan (one year after the original due date for the loan), reamortize the current loan value through the extended due date, and reach out to the payroll provider and custodian, as applicable, to initiate repayment from Gabriel's paycheck.

Evangeline's TPA prepared the initial loan documents and amortization schedule and will be able to assist her in preparing for the repayments. Gabriel's loan payments are made on each payroll, occurring on the 10th and 25th of each month. Therefore, his first loan repayment will need to occur on January 10, 2021. The TPA will calculate the accrued interest using the loan balance of the date his loan was suspended (June 10, 2020) through the date repayments restart (January 10, 2021) using the interest rate provided under the terms of the loan. Assume Gabriel took the

loan in June 2019 for the full allowable 60-month term, with an original final payment date of June 25, 2024. Gabriel's adjusted final payment date is one year later: June 25, 2025. The outstanding loan balance as of January 10, 2021, will be reamortized over this new term, ending June 25, 2025. Because the suspension period was only six months, but the repayment period for the loan is extended by a full year, the loan payment should be lower after the suspension than it was before. In addition to notifying the payroll provider and plan recordkeeper, it is advisable for Evangeline to send a notice to Gabriel so that he is aware of the date repayments will start, the new loan period, and the new repayment amount.

Required Minimum Distributions for 2021

The CARES Act offered plan participants a reprieve from required minimum distributions (RMDs) during 2020. (This did not apply to defined benefit and cash balance plans, or to tax-exempt 457 plans.) This means that RMDs will start up again for 2021. However, it is not as simple as turning the RMD switch back on. The 2020 reprieve will continue to affect administration in 2021.

Henry attained age 70½ in 2019 and, absent CARES, was due to begin taking RMDs for that calendar year. Henry's first RMD would then be due by April 1, 2020 (the law normally gives first time RMD recipients until the following April 1 to take the first distribution). The 2020 suspension means that Henry did not need to take the April 1, 2020, distribution, nor must he take the December 31, 2020, distribution required for the 2020 year. Henry's actual first RMD (which will be for the 2021 calendar year) need not occur until December 31, 2021 (although he can, of course, take it sooner).

SECURE changed the RMD rules so that participants born after July 1, 1949, are not required to take an RMD until they reach age 72 (a change from age 70½ requirement that applied before). Because RMDs were not required for 2020, 2021 will likely be the first year that many administrators will be applying the new age limit. Evangeline should doublecheck with her TPA and plan recordkeeper that its systems have been updated to reflect the age change (and check her own census information, as well, to prepare).

SECURE (and Other) Provisions Becoming Effective in 2021

Now that Evangeline has dutifully and deftly navigated the strange waters of CARES, she will need to turn her attention to SECURE, which will continue to influence plan operations in the new year.

<u>Late adoption of a new plan</u>. Because Acadia already has a plan in place, it is unlikely that Evangeline will have to make use of the late plan adoption availability under SECURE. However, if Henry suddenly decides a defined benefit plan is the right move, Evangeline should know that Acadia has until its tax filing deadline for its 2020 tax year, including extensions, to adopt a new plan for 2020. But wait – what about the funding deadline? Although Acadia would typically have until its tax filing deadline of October 15, 2021, to adopt a new plan for 2020, the funding deadline means that a pension plan will need to be adopted (and funded) by September 15, 2021. And, don't forget that there will be a Form 5500 due for that plan on the tax return due date, as well.

<u>Late adoption of a safe harbor nonelective contribution</u>. The Acadia Plan provides a basic safe harbor matching contribution, which was suspended in July 2020. Suppose that the safe harbor match was not reinstated at the beginning of 2021, as Henry is still concerned about the long-term financial impact of the coronavirus pandemic and does not take any action on the Plan before December 1, 2020, to add back the match or to provide notice to his employees about the safe harbor.

However, in July 2021, the company is in good condition and Henry now wants to provide a new safe harbor benefit to his employees. Under SECURE, Acadia may adopt a 3% safe harbor nonelective contribution provision for the 2021 plan year as late as December 1, 2021. This welcome extension allows plan sponsors additional time to determine their financial abilities and does not negatively impact participants, as their deferral elections have no effect on the amount of the employer's safe harbor contribution. Even if Henry is still feeling unsure by December 1, 2021, he may delay further, until December 31, 2022, if necessary, to adopt a 4% safe harbor nonelective contribution for the 2021 plan year. The 4% rate is required because of the extended deadline for adoption, but can revert to 3% for 2022 and later years. Note that this extension applies only for a nonelective contribution, and not for a safe harbor matching contribution.

Long-term part-time employees. Perhaps less welcome to plan sponsors is the looming administrative hassle of addressing long-term part-time employees ("LTPTs"). SECURE requires all plans with a cash or deferred arrangement feature to permit LTPTs to make elective deferrals to the plan, even if they otherwise do not meet the eligibility requirements for hours of service. An LTPT is someone who has at least 500 hours of service for three consecutive eligibility computation periods, counting only years from 2021 forward. LTPTs will not meet this requirement until, at the earliest, January 1, 2024. However, to determine whether someone will enter then, plan administrators must start tracking hours for part-time or seasonal workers in 2021 for plan purposes.

Practically, this means Evangeline may need to adopt a whole new approach for tracking hours for these employees. As noted above, the Acadia Plan's eligibility conditions are age 21 and 1,000 hours of service, so Evangeline has been able to ignore employees with fewer hours in the past. Now Evangeline will need to keep track of those employees who work between 500 and 1,000 hours in a year to determine if the new LTPT rules are met and, if they are, the affected participant must be permitted in 2024 and later to make elective deferrals.

Some TPAs do not require that a plan sponsor report census data for employees who work fewer than 1,000 hours if the plan uses the 1,000-hour requirement. Hopefully, Evangeline's TPA is proactive in asking for additional details going forward. If not, Evangeline will want to take special care to retain more detail for hours of service in her census records (and, possibly, report that to her TPA whether it is requested or not) in preparation for the 2024 change.

Qualified birth or adoption distributions. Qualified birth or adoption distributions ("QBADs") were permitted, starting in the 2020 plan year. A QBAD is a distribution of not more than $5,000 to someone who became a new parent through birth or adoption within 12 months before the distribution. It is exempt from the 10% pre-age 59½ additional tax and can be repaid to the distributing plan or an IRA at any time in the future. Similar to a CRD, any distribution can be a QBAD if the participant has given birth to or adopted a child. Evangeline may want to work with her Plan's TPA to modify distribution forms and notices so that she can best track such distributions. She will also need to remember that, if the Plan has allowed QBADs, the plan document must be amended by the end of the plan year beginning in 2022. As with CRDs, any repayment of a QBAD will be treated as a rollover, and Evangeline will need to allocate the repaid funds to the participant's rollover account in the Plan.

Qualified plan loan offsets. If a participant terminates employment or otherwise has a distributable event while a participant loan is outstanding, the plan may provide that the loan is "offset" against the vested account and considered repaid. If that occurs, the offset amount is taxable income to the participant. Historically, participants could "roll over" the loan by taking personal assets equal to the amount of the offset loan, and depositing those within 60 days of the offset to another qualified plan or an IRA.

Under new rules, participants may now roll over a qualified plan loan offset ("QPLO") to an individual retirement account or another qualified plan on or before the taxpayer's tax return due date for the year of distribution, if certain requirements are met, as opposed to the usual 60-day rollover window. Of course, a plan loan offset does not result in an actual distribution of funds. How, then, is a rollover effected and how must a plan administrator report a QPLO?

Suppose Gabriel terminates employment and, at that time, his participant loan has an outstanding balance of $20,000. Under the terms of the Plan, he has 90 days to repay the loan or the loan is offset against his account. His account balance in the Plan is $70,000 and he does not repay the loan. The Acadia Plan considers the loan to be in default, offsets the loan, and would distribute the remaining $50,000 in the account to Gabriel. Gabriel then starts a new job with Sister of Mercy Hospital and requests a direct rollover distribution from the Acadia Plan to the Sister of Mercy Plan. In preparing the Form 1099-R, Evangeline will ensure that Code M is used for the offset loan, and not Code L, as the offset is not a deemed distribution.

To effect the rollover of the loan, Gabriel must find personal assets of $20,000 and transfer them to the Sister of Mercy Plan or an IRA. (How or even whether he does that is not Evangeline's concern. Her job ended when she properly reported the loan offset on Form 1099-R.)

And a Restatement in a Pear Tree

Required and discretionary amendments must often be adopted by the end of the plan year. These regular amendments keep the plan running smoothly between larger full restatements, which are generally required every six years. As we head into 2021, we are gearing up for the Cycle 3 Restatements (or, as we prefer to call them, the Tricycle Restatements). Within the next 12 to 18 months, Evangeline can expect to hear from the Plan's TPA about preparing the next required restatement. This restatement must be adopted by July 31, 2022, although it may be adopted sooner. If any changes occur to the Acadia Plan before that date, it may be more economical for Evangeline to have the TPA prepare the Tricycle Restatement early to capture all requirements and changes in one go.

The Final Countdown

It is December 31, 2020. Evangeline is dancing alone in her apartment, wearing pajamas, drinking wine, and singing "Hold On" by Wilson Phillips repeatedly. The safe harbor and QDIA notices were distributed, Evangeline has a calendar alert for the beginning of the fourth quarter to remind Henry to take his first RMD, administration expenses were wired to the TPA from the ERISA Account, and an amendment for CRDs was adopted. The year is finally over, the Plan lives to fight another day, and as the sun comes up over 2021, Evangeline is able to sleep in, knowing she has kept the Plan operating correctly and protected the interests of all participants. Whatever legislation or plague may come, she will be able to handle it.

All of us at FBLC wish you, your loved ones, and your plan operations all the best in the new year. May 2021 be boring.

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