WRMarketplace

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TOPIC: COVID-19: Economic Challenges That Can Be Addressed Through 401(k) And Other Retirement Plans

MARKET TREND: The economic impact of the COVID-19 pandemic has created difficult challenges for employers that may impact 401(k) and other retirement plans. The CARES Act offers some relief for plan participants if employers take action. Meanwhile, employers may seek to reduce or defer plan costs.

SYNOPSIS: The economic fallout from the COVID-19 pandemic creates financial pressures on employees who may want to access their 401(k) benefits to meet those demands. Some existing plan features like plan loans or hardship withdrawals could help. The CARES Act adds additional features, like coronavirus-related distributions and enhanced plan loans, that employers can add to their plans. Employers that sponsor nonqualified deferred compensation plans may also offer withdrawals for unforeseeable emergencies. Meanwhile, employers face their own economic challenges. To address those challenges, employers may look to suspend, reduce, or eliminate employer matching or other contributions to their 401(k) plans. Reducing benefits requires employers to take action. For safe harbor 401(k) plans, additional compliance steps, including advanced notice to participants, apply before safe harbor contributions can be reduced. For employers that sponsor defined benefit pension plans, the CARES Act provides limited relief, such as an ability to delay certain 2020 required funding contributions until January 2021. The pandemic also creates challenges for participants forced to take required minimum distributions (RMDs) during 2020. The CARES Act waives all required minimum distributions for 2020. But participants who have already received an RMD payment this year, or whose plans require payments to be made during the year, will need to take action to roll over those amounts to an IRA or other eligible retirement plan to avoid current taxation on those payments.

TAKEAWAYS: To address the economic challenges created by the pandemic, employers must balance actions intended to immediately aid their employees with actions to cut expenses or conserve cash in order to ensure continuity of the business through the crisis. Actions to change 401(k) and other retirement plans, whether to add helpful features for participants or reduce employer costs, will trigger added costs in order to achieve the desired benefits (such as possible plan amendments, changes in administrative systems, etc.). Each employer will need to consider their own unique circumstances and weigh the various costs and benefits before deciding how to best proceed with any changes to their plans.

Employers face daily challenges trying to strike a balance between maintaining the long-term viability of their businesses and protecting the health and financial-wellbeing of their employees during the COVID-19 pandemic. As employers enter the second quarter of 2020, new challenges are beginning to arise concerning the company's tax-qualified 401(k) and other retirement plans and nonqualified deferred compensation ("NQDC") plans. Employers now must assess whether to offer employees access to certain relief under the CARES Act, whether to adjust funding schedules for defined benefit plans, whether to modify employer contributions to defined contribution plans, and whether to allow direct rollovers of distributions that would have been required minimum distributions but for the CARES Act.

Set forth below are some key considerations for employers as they confront these difficult challenges.

Challenge 1: Our Employees Need Financial Assistance.

1. Qualified Retirement Plan Relief.

The CARES Act offers financial assistance to qualifying individuals through distributions and loans from their 401(k) plans and other qualified retirement plans.

Coronavirus-Related Distributions. Under the CARES Act, employers *may* allow "qualified individuals" to take a coronavirus-related distribution from their retirement account up to a maximum of $100,000 until December 31, 2020. For this purpose, a "qualified individual" is an individual who (i) has been diagnosed, or whose spouse or dependent has been diagnosed with COVID-19 using a test approved by the Centers for Disease Control and Prevention, or (ii) experiences adverse financial consequences as a result of being quarantined, being furloughed or laid off, or having work hours reduced due to COVID-19, or their being unable to work due to lack of child care because of COVID-19 or because of the closing or a reduction in hours of a business owned or operated by the individual. Given the broad impact of the pandemic on employees so far, it seems likely that many participants in 401(k) plans can certify that they are a "qualified individual."

The CARES Act also offers a qualified individual favorable tax treatment for coronavirus-related distributions. For example, qualified individuals are not be subject to the normal 20% mandatory withholding tax or the 10% early withdrawal penalty tax usually applicable to payments made to employee before reaching age 59 ½.

Employees are still subject to income tax on these coronavirus-related distributions. The CARES Act, however, allows employees to elect to pay tax on the distribution ratably over a three-year period. In addition, the CARES Act offers expanded flexibility by allowing employees to repay the distribution to the retirement plan, if still employed, or rollover the distribution to an IRA or other tax-qualified plan within the three-year period to avoid recognizing the tax.

Enhanced Participant Loans. Defined contribution plans are permitted, but not required, to allow participant loans subject to certain limits and restrictions. Generally, participant loans cannot exceed the lesser of $50,000 or 50% of a participant's vested account balance. However, for participants that meet the coronavirus-related distribution requirements, employers may increase the loan limit to the lesser of $100,000 or 100% of a participant's vested account balance for a loan issued within 180 days after the CARES Act enactment date (March 27, 2020). Moreover, if a qualified participant had a plan loan outstanding on or after March 27, 2020, the CARES Act delays the due date for any loan repayment that is due between March 27, 2020 and December 31, 2020. (It is not entirely clear at this time whether this one-year loan repayment deferral is permissive or mandatory under the CARES Act. The language of the CARES Act appears to require the repayment deferral, but in prior disasters where similar relief was provided, Treasury and the IRS interpreted the relief as permissive.) Keep in mind, however, that interest will continue to accrue while the loan is in forbearance. Thereafter, the loan repayment schedule will be recalculated to reflect the delayed due date and any interest that accrued during the forbearance period. This delayed due date will be disregarded for purposes of determining whether the loan's term satisfies the five-year repayment period under the Internal Revenue Code of 1986, as amended (the "Code").

Although, these CARES Act relief measures can be implemented immediately, employers electing to allow employees to take advantage of them will need to adopt amendments to the plan by last day of the first plan year beginning on or after January 1, 2022 (December 31, 2022 for calendar year plans). Employers should coordinate with third-party service providers and recordkeepers to ensure that they have the requisite processes in place to apply these changes in an efficient manner.

Hardship Withdrawals. Most 401(k) plans permit hardship withdrawals. Depending on the circumstance, employees may be able to take a hardship withdrawal as a result of COVID-19. In order to take a hardship withdrawal, a participant must certify that (i) he or she (or, in some cases, spouse, child, dependent or primary beneficiary) has an "immediate and heavy financial need," and (ii) the distribution is necessary to meet that financial need. Generally, plans utilize the "safe harbor" rules to determine whether the participant has an immediate and heavy financial need. Although many requests likely fall outside of the purview of the safe-harbor rules, three options may be available:

- Expenses for medical care previously incurred by the employee, the employee's spouse, any of the employee's dependents or the employee's primary beneficiary under the plan; or expenses necessary for those persons to obtain medical care (but limited to expenses for medical care that are deductible under Code § 213);
- Payments necessary to prevent the eviction of the employee from the employee's principal residence or foreclosure on the mortgage on that residence; and
- Expenses and losses incurred by an employee on account of a disaster declared by the Federal Emergency Management Agency ("FEMA") \, provided that the employee's principal residence or principal place of employment at the time of the disaster was located in an area designated by FEMA for individual assistance with respect to the disaster.

While it is clear COVID-19 could trigger medical expenses for which a hardship distribution is available, it is less likely for withdrawals to prevent foreclosure and eviction because the federal government and many states have instituted moratoriums on evictions and foreclosures. Additionally, there is confusion surrounding whether the President's declaration of a state of emergency for COVID-19 designating all 50 states, the District of Columbia, and the territories as disaster areasconstitutes the requisite individual assistance under FEMA for purposes of the hardship safe harbor rules. As such, employers should exercise caution before allowing hardship distributions under this safe harbor until further guidance is issued.

Employers could also consider amending their plans to apply a facts and circumstances test to allow for withdrawals due to COVID-19 that result in an immediate and heavy financial need. Plan sponsors should review their plan documents before implementing this change and carefully define the parameters of such relief.

1. NQDC Plan Relief.

Code Section 409A imposes very strict rules regarding time and form of payment from NQDC plans. However, one permissible payment event under Code Section 409A is through an unforeseeable emergency distribution. An unforeseeable emergency is a severe financial hardship of the participant (or the participant's spouse, beneficiary, or dependent) resulting from an illness, accident, or other similar extraordinary and unforeseeable circumstances arising from events beyond the participant's control that cannot be met by other financial means. Whether a participant or beneficiary faces an unforeseeable emergency permitting a distribution is determined based on the relevant facts and circumstances of each case. In the light of the magnitude of the current pandemic, participants may be able to meet the necessary requirements for such a withdrawal, particularly if the participant incurs substantial medical expenses as a result COVID-19.

Employers without this distribution event in their NQDC plans can amend their NQDC plans to add it and apply it to amounts already deferred under the plan.

Challenge 2: Our Company Needs to Conserve Cash.

1. Reduced Employer Contributions to 401(k) Plans.

Non-Safe Harbor 401(k) Plans. For non-safe harbor 401(k) plans, the Code offers significant flexibility to reduce or eliminate employer contributions. If the employer maintains a non-safe harbor plan with discretionary matching contributions or discretionary nonelective/profit-sharing contributions, the employer can simply choose not to make the contribution, without amending the plan. For employers with formulaic non-safe harbor matching or other employer contributions, the employer can elect reduce or eliminate contributions prospectively, but a plan amendment must be adopted before implementing the reduction.

Plan sponsors should look at their plan documents as well as participant communications to determine if there are any restrictions on amending contributions, or if participants have already met the conditions to receive such contributions. For plans covering collectively bargained employees, any contribution reductions likely require agreement with the applicable union. Although advance notice is not legally required to make these changes, it will likely be advisable from an employee-relations perspective to communicate these changes in advance.

Safe Harbor 401(k) Plans. The ability to reduce or suspend employer contributions to safe harbor 401(k) plans is much more restrictive and special rules apply. First, safe harbor plans may only be amended prospectively to reduce or suspend safe harbor contributions if the previously distributed safe harbor notice indicates that such contributions can be reduced or suspended, or if the employer is operating at an economic loss for the plan year. Second, in order for an employer to reduce or suspend safe harbor employer contributions, it must provide 30-day advance notice to participants, during which time employer contributions must continue. Finally, plans that reduce or stop safe harbor contributions must satisfy applicable nondiscrimination testing (ADP and ACP tests) for the full plan year. This testing could require a return of some employee contributions to certain highly compensated employees and reductions in any matching contributions that were made.

1. Delayed Funding Contributions for Defined Benefit Plans.

Employers with defined benefit pension plans are required by the Code to make certain minimum contributions to the plan. In times such as these where there is poor market performance and low long-term interest rates, employers with pension plans could face increased pension funding obligations, which in turn could adversely affect the company’s cash flow.

However, the CARES Act provides relief to employers with single-employer pension plans by allowing them to delay making required contributions, including quarterly payments otherwise due in calendar year 2020; provided that the delayed payments are made with interest by the following dates:

2020 Contributions	**Original Deadline**	**New Deadline**
First Quarter	April 15, 2020	January 1, 2021
Second Quarter	July 15, 2020	January 1, 2021
Third Quarter	September 15, 2020	January 1, 2021
Fourth Quarter	October 15, 2020	January 1, 2021

In addition, employers may elect to treat the plan's adjusted funding target attainment percentage ("AFTAP") for the last plan year ending before January 1, 2020 as the AFTAP for plan years, including 2020. Thus, by utilizing the plan's 2019 AFTAP employers may be able to mitigate any declines in the pension plan's AFTAP during 2020.

Since these CARES Act provisions are not mandatory to pension plans, employers should evaluate the following considerations before amending its plan:

- Current cash flow: If the employer needs immediate financial relief it may make more sense to delay making required minimum distributions; however, if cash flow is not an issue now could be a good time to take advantage of declining equity prices; and
- Whether it would be more favorable to rely on the pension plan's 2019 AFTAP or continue to assess the plan's funded status in accordance with its normal practices.

1. <u>Limited Delay in NQDC Plan Payments</u>.

For cash-strapped employers with NQDC payments due in 2020, Code Section 409A generally prohibits delaying payments. However, Section 409A does permit employers to delay the timing of a 2020 payment to December 31, 2020. This would allow employers to conserve cash in the interim, but they will need to be mindful that the payment remains outstanding and must be paid by the end of the year to avoid a Section 409A violation. Employers would also need to check their NQDC plan documents to see if they have the contractual right to unilaterally delay a payment that is otherwise due.

In more extreme cases, Section 409A permits delaying payments that, if made, would jeopardize the employer as a "going concern." Whether this provision might apply depends on the facts and circumstances. The IRS has indicated that relief under this provision should be narrowly interpreted.

Challenge 3: How Can We Protect Participants who Have Received, or are Scheduled to Receive, Required Minimum Distributions in 2020.

Generally, when participants attain age 70 ½ (for 2019 and earlier years) or age 72 (beginning in 2020) while no longer in service, they must begin receiving RMDs from their defined contribution plans. However, in order to prevent forced withdrawals from retirement accounts while markets are down as a result of the pandemic, the CARES Act waives RMDs that are otherwise required for 2020. This waiver extends to RMDs for plan participants who first turned age 70 ½ in 2019 and received their 2019 RMD during 2020 (by April 1, 2020). This waiver also covers 2020 RMDs required for participants who first turn age 72 in 2020, which RMDs must be made by April 1, 2021. By waiving RMDs otherwise payable in or for 2020, the hope is that participants will be able to maintain their retirement accounts until at least 2021.

In some cases, payments that were intended to be RMDs have already been paid this year, or under the terms of the applicable plan may still be required to be paid later this year. Normally, RMDs cannot be rolled over to an IRA or other eligible retirement plan. But because the CARES Act waives status as an RMD for these 2020 payments, the amounts are eligible for rollover. The CARES Act does not require these payments to be subject to certain rules that normally apply to rollover-eligible payments, such as the mandatory 20% tax withholding and direct rollover notice and elections. Employers may, however, chose to treat these payments as eligible for direct rollover and provide participants with a direct rollover election for the payments.

Even if an employer does not extend the direct rollover opportunity to participants, a participant may choose to roll over the payment within 60 days after receipt. This 60-day requirement presents a potential challenge to participants who previously received a payment in 2020. For example, if a participant received what they thought was an RMD on February 1, 2020 but now finds out the payment was eligible for rollover, the 60-day rollover period will have lapsed. Internal Revenue Service Notice 2020-23 appears to provide some relief for this issue, delaying the deadline to July 15, 2020 for certain "time-sensitive actions" with a deadline on or after April 1, 2020 and before July 15, 2020. "Time-sensitive actions" appears to include completion of a rollover within the normal 60-day grace period. This should mean that an RMD received between February 1, 2020 and May 15, 2020 may be rolled over to a new IRA or other eligible retirement plan if done prior to July 15, 2020. The relief in the Notice, though, does not appear to help an individual who received an RMD in January 2020. Perhaps Treasury and the IRS will provide special relief for these individuals.

Employers who wish to treat RMD payments due for the remainder of the year as eligible for direct rollover should engage with their third-party service providers and recordkeepers in order to implement that treatment.

Conclusion

Employers should continue to closely the monitor the needs of their employees and the financial stability of their business to determine how to best respond to the unique challenges presented by the COVID-19 pandemic. Responding to the financial needs of employees presents difficult decisions for employers, and a thoughtful evaluation of the costs and benefits should be conducted before deciding whether to change their plans to provide for the CARES Act relief provisions. Similarly, decisions to reduce employer contributions under 401(k) plans or take other actions to reduce or delay employee costs need to be carefully weighed and communicated. Such actions may require plan amendments, either immediately or by the remedial amendment deadline provided by the CARES Act. Actions will also likely require changes to plan administrative systems, and participant communications may be required or advisable. To weigh the costs and benefits and fully consider all required steps to implement any changes, employers should review with a team that includes key financial, human resources, and legal advisors.