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INFORMATION MEMO
EMPLOYEE BENEFITS LAW
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IRS Issues Helpful Guidance on the SECURE Act Retirement Plan Changes

The SECURE Act (Setting Every Community Up for Retirement Enhancement Act), signed into law on December 20, 2019, included several significant changes relating to qualified retirement plans. Our previous Information Memo briefly described the most important of these changes. Although many of these changes were effective immediately, the IRS did not issue any SECURE Act guidance for the first eight months after the Act was passed. Doubtless this was, in part at least, due to the fact that the coronavirus pandemic and the federal legislation (including the CARES Act) passed in response to the crisis took precedence.

However, on September 2, 2020, the IRS published Notice 2020-68, which provides answers to at least some of the open questions concerning the retirement plan changes under the SECURE Act. In particular, the notice includes useful guidance on the Act's new rules regarding 401(k) plan participation by long-term, part-time employees and so-called "qualified birth or adoption distributions" (QBOADs).

Long-Term Part-Time Employees and 401(k) Plans

Most 401(k) plans require employees to complete a "year of service" – that is, work 1,000 hours in a 12-month period – in order to begin participating in the plan. Accordingly, part-time employees are often denied the opportunity to make pre-tax contributions to their employer's 401(k) plan, even if they work part-time for many years. In addition, if part-time employees *do* work enough hours in one year to get into a 401(k) plan, they often cannot earn a vested right to employer contributions under the plan (if any), because a year of vesting service also typically requires that a participant work 1,000 hours in a year.

The SECURE Act includes two provisions that are designed to help part-time employees participate meaningfully in their employers' 401(k) plans. Note that these provisions do <u>not</u> apply to collectively bargained 401(k) plans.

Eligibility to Participate

First, the SECURE Act requires 401(k) plans to permit certain "long-term, part-time employees" to make elective deferrals to the plan. Specifically, the Act provides that a part-time employee who works for their employer for 500 or more hours per year for three consecutive years must be permitted to make pre-tax contributions to their employer's 401(k) plan.

So, beginning January 1, 2021, a 401(k) plan must allow an employee to participate in elective deferrals on the earlier of:

- the first entry date after the employee has completed at least 1,000 hours of service, or
- the first entry date after the employee has completed at least 500 hours of service in three consecutive 12-month periods.

In each case, the plan can also require that an employee reach age 21 before participating.

Vesting in Employer Contributions

The Act does not require that long-term, part-time employees receive matching contributions or any other employer contributions. However, if long-term part-time employees *are* included in employer contributions that are subject to a vesting schedule, a special rule applies for determining the employee's service for purposes of vesting: the employee must be credited with a year of vesting service for each 12-month period during which the employee has at least 500 hours of service. (As with the eligibility rule, 1,000 hours normally are required to earn a year of vesting service.) This special vesting rule only applies to part-time employees who become eligible to participate in the plan by reason of the new eligibility rule. In other words, the special vesting rule does not apply to participants who met the plan's regular participation requirement – typically, reaching age 21 and working 1,000 hours in a 12-month period.

The SECURE Act states that 12-month periods beginning before January 1, 2021 are not taken into account in determining a part-time employee's eligibility to participate in a 401(k) plan. Importantly, the IRS Notice clarifies that all periods of service, including those that begin before January 1, 2021, *are* taken into account for purposes of the special vesting rule, with some exceptions, such as periods before the employee had reached 18 years of age.

Thus, although 401(k) plan sponsors are not required to cover long-term, part-time employees beginning next year, sponsors *will* have to modify their administrative systems to track eligibility and vesting service for part-time employees beginning January 1, 2021.

Qualified Birth or Adoption Distributions (QBOADs)

Most in-service distributions from qualified retirement plans before the participant has reached age 59½ are subject to a 10% "early distribution" tax. There are a number of exceptions that permit pre-59½ distributions without triggering the 10% penalty tax in certain situations, such as where the participant has unreimbursed education expenses or costs relating to the purchase of a new home.

The SECURE Act added a new exception to the 10% penalty tax for in-service distributions of up to $5,000 within one year of the birth or adoption of a child of a participant. The IRS Notice includes a number of detailed Q&As relating to these "QBOADs" (qualified birth or adoption distributions). Notably, the Q&As clarify the following questions concerning these distributions:

- Plan sponsors may, but are not required to, permit these distributions. However, if a plan does *not* permit these distributions, a participant may still treat an otherwise permissible in-service distribution from the plan as a qualified birth or adoption distribution so as to avoid the 10% early distribution tax.
- The $5,000 limit applies per child, not per birth or adoption, so if a participant gives birth to or adopts twins, the employee can request two QBOADs.
- Absent actual knowledge to the contrary, a plan sponsor can rely on the participant's self-certification that he or she is eligible to receive a qualified birth or adoption distribution.
- If a plan permits qualified birth or adoption distributions, it must permit a participant to repay a QBOAD to the plan if the participant is otherwise eligible to make a rollover contribution to the plan.
- As with coronavirus-related distributions under the CARES Act, qualified birth and adoption distributions are not treated as eligible rollover distributions, so the mandatory 20% withholding tax does not apply.

Plan Amendment Deadlines

For qualified retirement plans and 403(b) plans, amendments to reflect the retirement plan changes under the SECURE Act are not required until the last day of the first plan year that begins on or after January 1, 2022. So, for plans with a calendar plan year, the deadline is December 31, 2022.

For governmental and collectively bargained plans, amendments aren't due before the last day of the first plan year beginning on or after January 1, 2024.

The IRS Notice clarifies that the same deadlines apply to both discretionary and required SECURE Act amendments.

If you have any questions about this information memo, please contact Rob Patterson, any attorney in our Employee Benefits and Executive Compensation practice or the attorney at the firm with whom you are regularly in contact.

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