Retirement Plan Updates

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I. Updates to the Employee Plans Compliance Resolution System (EPCRS)

A. EPCRS Overview. The EPCRS is the IRS’ program allowing qualified retirement plans to correct disqualifying errors, including:

* Operational Failures
* Plan Document Failures
* Demographic Failures
* Employer Eligibility Failures

EPCRS has three correction programs:

* Self-Correction Program (SCP) – Correction without review or approval by the IRS
* Voluntary Correction Program (VCP) – Correction via an IRS filing with IRS approval
* Audit Closing Agreement Program (Audit CAP) – Correction after error is discovered upon IRS audit


B. Online VCP Applications. On September 28, 2018, the IRS updated the EPCRS. The primary adjustment under the new guidance relates to how plan sponsors must file VCP applications with the IRS. Beginning January 1, 2019, and ending March 31, 2019, applicants had the choice to make VCP submissions to the IRS either by electronic submission or a paper submission. Beginning April 1, 2019, all VCP submissions must be made electronically using Pay.gov. The IRS will return unprocessed any paper submissions mailed on or after this date.

Applicants must also pay the VCP filing fee online. The applicant must convert the entire filing into a PDF document that does not exceed 15MB. Additional materials above that size limit must be faxed to the IRS. Revenue Procedure 2018-52, section 11.03. https://www.irs.gov/retirement-plans/updated-retirement-plan-correction-procedures

C. Participant Loan Errors. On April 19, 2019, the IRS again reissued an updated EPCRS – Revenue Procedure 2019-19. The new EPCRS gave additional flexibility in correcting participant loan errors via SCP, rather than having to file a VCP application. Previously, many participant loan errors technically required a VCP application to correct. The new EPCRS allows for self correction for a number of these types of errors.

1. **Defaulted Loans.** When a participant defaults on a loan (due to missed payments), the plan can correct the default by (1) having the participant repay all missed payments plus interest in a single lump sum payment, (2) reamortizing the overdue principal plus interest over the remaining period of the loan, or (3) a combination of the prior two correction methods. This correction method is not available if the maximum period of the loan has expired. If the plan does not fully correct the loan, the plan must report the remaining defaulted amount to the IRS as taxable to the participant. However, the 1099-R can be filed for the current year, not the year of the default (thus preventing the participant from having to re-file their 1040 from the year of the default).

2. **Failure to Obtain Spousal Consent.** Not all plans require spousal consent for a participant loan. But for plans that do require spousal consent for participant loans, and did not obtain it, the new EPCRS allows a self correction option. The plan sponsor must notify the participant and the participant’s spouse (at the time of the loan), and obtain the spousal consent to the plan loan.

3. **Too Many Loans.** A plan may – in the terms of the plan document or the plan loan policy – limit the number of loans that a participant can have outstanding at any given time. If the plan issues loans to a single participant in excess of that limit, the EPCRS now allows for self correction of the error through the retroactive amendment to conform the terms of the written plan document to the plan’s actual administration. Previously, the EPCRS allowed for plans to self correct through retroactive amendment situations where the plan allowed participants to take loans, but the plan document did not contain provisions allowing for participant loans.

4. **No Self Correction.** The new EPCRS does not expressly permit self correction for loans in excess of the $50,000 limit, nor loans that permit a repayment period beyond five years (except for principal residence loans). Read technically, the ECPRS still requires a VCP application to correct these types of participant loan errors.

D. **Retroactive Amendments to Self Correct Operational Errors.** The new EPCRS expands opportunities for plan sponsors to self correct certain operational failures via a retroactive plan document amendment that conforms the plan document to the actual administration of the plan. To self correct through a retroactive amendment, the following conditions must apply:

* The corrective amendment results in an increase of a participant’s benefit, right or feature
* The increase in benefit, right or feature “applies to all employees eligible to participate in the plan”
* providing the increase in the benefit, right or feature is permitted under the Internal Revenue Code and satisfies the general correction principles of the EPCRS

SCP is not available to retroactively amend the written plan to conform to the plan’s operation if the operational failure did not provide for a uniform increase in benefits, rights or features to all employees eligible to participate in the plan. However, this correction may be available under VCP or, if under audit, Audit CAP. Revenue Procedure 2019-19, section 4.05(2)(a).

E. **Retroactive Amendments to Self Correct Plan Document Errors.** The new EPCRS expands opportunities for plan sponsors to self correct certain plan document failures via a retroactive plan document amendment. Specifically, plan sponsors can self correct a failure to adopt interim amendments (i.e., amendments that are required to be made due to a legal or regulatory change) if certain requirements are met. The IRS does not consider late adoption of discretionary amendments as a plan document failure, so self-correction is not available for those types of amendments. Additionally, plan sponsors cannot self correct the failure to timely adopt the initial plan document.

The IRS considers plan document failures as significant, and permits plan sponsors to self correct them within the two plan years following the plan year in which the error occurred. Plans must have a favorable determination letter or reliance on a pre-approved plan document’s favorable advisory letter or opinion letter. Eligibility for self correction requires that the plan have “practices and procedures” in place to prevent the error. Revenue Procedure 2019-19, section 4.03.

II. IRS Determination Letter Program Expands

A. Statutory Hybrid Plans. Plan sponsors may submit determination letter applications for statutory hybrid plans for the 12-month period beginning September 1, 2019, and ending August 31, 2020. Hybrid plans will include cash balance plans, pension equity plans, and certain variable annuity plans. Revenue Procedure 2019-20, § 4.01.

B. Plan Mergers. Beginning September 1, 2019, the IRS began accepting determination letter applications with respect to merged plans. Only individually designed plans may take advantage of this opportunity to file for an IRS determination letter. The rule applies only to situations where two or more plans maintained by previously unrelated entities merge into a single individually designed plan, and the plan merger occurs in connection with a corporate merger, acquisition or other similar business transaction among unrelated entities that each maintained their own plan prior to the plan merger. Revenue Procedure 2019-20, § 5.01.

The IRS will accept determination letter applications submitted for merged plans on an ongoing basis. The IRS does not limit the rule to a specific submission period, nor does the IRS impose a sunset date on the rule. To qualify for a determination letter, the plan merger must occur no later than the last day of the first plan year that begins after the plan year that includes the date of the corporate merger or similar transaction between the unrelated entities. The plan sponsor must submit the determination letter application for the merged plan before the last day of the first plan year beginning after the date of the plan merger. Revenue Procedure 2019-20, § 5.02.

Example: Company A purchased Company B on June 30, 2019. Both Company A and Company B sponsored 401(k) plans with calendar plan year. On July 1, 2020, Company A and Company B merged their two plans into a single plan that used an individually designed plan document. Company A has the option to file the merged plan for a determination letter no later than December 31, 2021.

Additional information on the expanded determination letter program can be found on the IRS’ website at https://www.irs.gov/newsroom/irs-expands-retirement-plan-determination-letter-program-and-self-correction-program

C. Pre-Approved Plans.

1. Pre-Approved defined benefit plans received IRS approval letters in early 2018. The window to begin restating defined benefit plans on a pre-approved document opened May 1, 2018. The deadline for restating defined benefit plans on a pre-approved document for PPA will be April 30, 2020.
2. Pre-Approved defined contribution plans were required to be submitted to the IRS for the Third Restatement Cycle by December 31, 2018. The IRS has stated that they intend to issue opinion letters on all pre-approved defined contribution plans by Summer of 2020. Based on that time line, the window for restating defined contribution plans on pre-approved documents will run from mid-2020 until sometime in 2022.

Additional information on the Third Restatement Cycle can be found on the IRS’ website at https://www.irs.gov/retirement-plans/2017-pre-approved-retirement-plan-opinion-letter-program

III. Hardship Rules

A. Casualty Hardship Distributions. The Tax Cuts and Jobs Act of 2017 (TCJA) did not change the hardship regulations. But one of the permissible hardship triggers is damage to a participant’s home that is deductible under the casualty rules in Internal Revenue Code section 165. TCJA does restrict what can be deducted under the casualty rules, and therefore what a plan participant can use as a basis for a hardship distribution. Previously, the source of the damage to the home did not matter. Under the TCJA rule, only damage to your home caused by a federally declared disaster can qualify as a casualty.

However, the IRS proposed regulations in November 2018 undoes this new rule for purposes of hardship distributions. The new regulations revert casualty hardship distributions to their prior rule – the source of the damage to the home does not have to be a federally declared disaster.

B. Changes to Hardship Distribution Rules Under the Bipartisan Budget Act of 2018 (BBA). The BBA included a number of changes to the hardship distribution rules, effective for plan years beginning on or after January 1, 2019:

1. Participants will no longer be required to take a loan from the plan (if permitted under the plan’s terms) before taking a hardship distribution;

2. Participants will no longer be subject to a required 6 month suspension on hardship distributions following a hardship distribution;

3. Participants can take hardship distributions from safe harbor sources, as well as QNECs, QMACs and earnings from elective deferrals.
C. **Proposed IRS Regulations.** In November, 2018, the IRS proposed changes to the regulations addressing hardship distributions. The treasury regulations have always required hardship distributions to meet both an “events” test (i.e., has the participant incurred an event that triggers a financial hardship) and a “needs” test (i.e., does the participant need to take a distribution from the plan to meet that financial hardship). The proposed regulations make significant changes to both the events test and the needs test.

**Changes to the hardship “needs” test include:**

1. During 2019, plans may still impose the deferral suspension following a hardship distribution. Beginning in 2020, plans **may not** impose any deferral suspensions following a hardship distribution. Plans may continue to impose a requirement that participants take a loan prior to requesting a hardship. The expansion of hardship availability to QNECs, QMACs, safe harbor contributions and earnings on deferrals is optional.

2. Current regulations allow for either a “safe harbor” approach or a “facts and circumstances” approach under the needs test. The proposed regulations eliminate those options and replace them with a single general standard. Under the new standard, a hardship distribution meets the needs test if (1) the distribution does not exceed the amount of the need (plus taxes), (2) the participant has obtained other available distributions (other than a plan loan) and (3) the participant must represent they have insufficient cash or other liquid assets to satisfy the financial need. The plan administrator may rely on that representation unless they have actual knowledge to the contrary.

**Changes to the hardship “events” test include:**

3. The proposed regulations add a new hardship distribution trigger, relating to expenses incurred as a result of federally declared disasters. The new hardship distribution trigger is more broad than simply repairing costs to the participant’s home. It can cover any expense incurred as a result of the disaster, including lost earnings.

4. The treasury regulations now expressly permit hardship distributions due to medical, education or funeral expenses of the participant’s primary beneficiary. Previously, plans were permitted (but not required) to allow those distributions under IRS Notice 2007-7. Are plans that use the safe harbor approach to the events test now required to permit distributions based on beneficiary hardships? Hopefully, the final regulations will answer that question.
IV. Multiple Employer Plans (MEPs)

A. **Overview.** Statistics have long demonstrated that people with access to retirement savings vehicles through their employer (e.g., 401(k) plans, 403(b) plans, 457(b) plans) have greater levels of retirement security than those that don’t. Statistics also demonstrate that employees of smaller employers are more likely to have no access to a retirement savings program through work. Many have advocated MEPs as a way of giving employees of smaller companies access to a retirement savings vehicle through their employment.

B. **2018 Executive Order.** On August 31, 2018, President Trump signed an executive order relating to retirement security in America. The order encourages the IRS and DOL to develop guidance relating to a number of topics, including revisions to the MEP rules and requirements with the goal of expanding access to retirement savings for tens of millions of Americans. The executive order is available on the White House website at https://www.whitehouse.gov/presidential-actions/executive-order-strengthening-retirement-security-america/.

C. **DOL Proposed Regulations.** In response to this executive order, the DOL issued proposed regulations on October 22, 2018 to expand the availability of multiple employer defined contribution plans. The DOL finalized these regulations on July 29, 2019. (The regulation uses the term “association retirement plans”, not “multiple employer plans.”) The regulation does not authorize “open MEPs”, under which the participating employers have no common relationship other than sponsoring the plan. Under the proposal, a bona fide group or association can sponsor a MEP. To be bona fide, the employers in the group must have a commonality of interest, such as being in the same trade or industry, or within the same geographic area.

Additional information about the final regulation can be found on the DOL website:

https://www.dol.gov/newsroom/releases/ebsa/ebsa20190729


D. **Court Challenges.** On March 28, 2019, the District Court for the District of Columbia blocked key provisions of the DOL’s final rule relating to Association Health Plans. The DOL’s proposed MEP regulations substantially mirror the health plan final rule. As a result, if the DOL finalizes the MEP regulations as proposed, it could be subject to a successful court challenge.

E. **Proposed IRS Regulations.** On July 3, 2019, the IRS issued proposed regulations that would undo the “one bad apple rule”, which the regulations refer to as the “unified plan rule”. Under that rule, any disqualifying error by any employer in the MEP will disqualify the entire plan. Under the proposed regulations, an error by an employer in a MEP will not disqualify the MEP if (1) the plan administrator provides multiple notifications to the employer about the error, (2) in the event that the employer does not correct the error, the plan administrator will spinoff the employer’s assets into a separate plan and terminate that plan and (3) the plan administrator reports the spinoff/termination to the IRS.

F. **Potential Legislative Solutions?** The Setting Every Community Up for Retirement Enhancement (SECURE) Act contains substantial provisions that would allow for the expansion of MEPs, which the legislation refers to as “pooled employer plans”. The SECURE Act passed the House of Representative on May 23, 2019 by a vote of 417-3. The Retirement Enhancement and Savings Act in the Senate contains similar provisions.