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SECURE Act surprises for plan sponsors and TPAs

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The Setting Every Community Up for Retirement Enhancement (SECURE) Act affects federal laws for employer-sponsored retirement benefit programs and contains a few features that may surprise employers and their third-party administrator (TPA) business partners.

Let's define "surprise" as actions that an employer must take, or may take, but more importantly, that involve complex changes to human resources (HR) administration systems and savings plan calculation engines. We leave it to the reader to evaluate the level of urgency for addressing the new law, which was enacted on December 20, 2019.

For this article, let's focus on two SECURE legislation changes, one mandatory and the other voluntary.

Mandatory change

The "Long-time/Part-time" (LTPT) provision calls for employees historically considered "part-timers" to be extended the opportunity to participate in 401(k) savings plans under certain circumstances.

In plan years beginning after December 31, 2020, an employer must keep track of hours worked by employees who are "part-time" and work at least 500 hours during the year (in accordance with their savings plan provisions).

If a part-timer works at least 500 hours and accumulates three consecutive years of service (beginning in 2021), the employer must permit these LTPT employees to defer a portion of their compensation to the 401(k) savings plan.

a. **Example:** Employee A works at least 500 hours in 2021, 500 hours in 2022, and 550 hours in 2023. Employee A becomes eligible to make voluntary salary deferrals to the 401(k) plan in 2024.
   i. Employee A may no longer be subject to this new rule if Employee A becomes a full-time employee (such as by meeting a 1,000-hour rule).

b. The savings plan can require eligibility based on age to meet this SECURE requirement. In the above example, the plan could state the employee has to be age 21 by the end of 2023 for the entry date to be January 1, 2024.

1. Further Internal Revenue Service (IRS) clarification is likely needed because SECURE refers to "three consecutive 12-month periods." The 12-month period perhaps could include two consecutive plan years, or a reasonable method on when a "12-month period" starts.
   a. As well, there may be a need for guidance on distinctions between elapsed time methods and counting of the actual hours worked.
2. The employer is not required to match the LTPT employee's savings plan deferrals or provide any other employer contribution.
   a. Regarding accumulation of vesting service, a good faith interpretation may be that an employer choosing to contribute a match or a nonelective amount, etc., will likely need to accumulate vesting service. Otherwise, vesting service is irrelevant.
3. The employer can exclude LTPT employees in the annual IRS coverage, nondiscrimination, and top-heavy testing.
4. The LTPT provision does not apply to 403(b) or 457(b) plans, nor does it apply to plans subject to collective bargaining.

Voluntary change

With the qualified birth or adoption distribution, employees participating in the qualified savings plan who are new parents can opt to receive a qualified birth or adoption distribution of no more than $5,000 from the savings plan. Here are the specifics:

1. For tax years beginning January 1, 2020, an employer can amend the qualified savings plan to offer this feature. Eligible savings plans include 401(k), 403(b), and 457(b).
2. This in-service withdrawal can be allowed by amending the savings plan even if the plan does not currently permit other types of withdrawals.
3. The distribution received is exempt from the 10% early withdrawal personal income tax penalty, mandatory federal 20% tax withholding, and direct rollover rules.
4. The distribution is impermissible if the child to be adopted is the child of the participant's spouse.
5. The $5,000 amount applies on an individual basis. For married couples with eligible savings plans, each spouse may receive a penalty-free distribution up to $5,000.

6. The distribution should occur within one year following birth or adoption of the child.
7. The provision allows an employee to repay the distribution but additional regulatory guidance is needed on this. (This distribution is not a plan loan.)

There are other rules for the qualified birth or adoption distribution, some of which also apply to IRA accounts, which are not discussed here.

Will plan sponsors be surprised and what actions can be taken to avoid surprises?

1. The mandatory LTPT employees rule will require employers to assess the plan document amendments and the ability of their HR systems to track such hours and employee classifications (including proper accumulation of vesting service, and addressing elapsed time methods). This is not to imply that current HR systems cannot perform such calculations, but rather there will now be a federal mandate.
   a. HR systems may need to be recalibrated and tested in advance of plan years starting after December 31, 2020.
   b. Because SECURE will permit exclusion of LTPT employees in the annual IRS technical tests for coverage and nondiscrimination, perhaps adding a new “flag” on the electronic record will suffice.
   c. Employers may wish to review general classifications of their exempt or nonexempt employees, particularly because the U.S. Department of Labor changed such regulatory guidance in 2019.
2. Because the qualified birth or adoption provision is voluntary, a plan sponsor may likely want to assess the demand or need for such a provision (with accompanying plan amendments and communication). The technical side of implementing this provision could be complex.
   a. Some practitioners have speculated that the IRS will have to develop a new Form 1099-R for such distributions, or at least amend the current Form 1099-R, because the withholding of federal taxes is not permitted. However, it is a taxable event. Similar changes could be required by any state tax withholding rule although SECURE is federal law that does not necessarily synch up with state requirements.
   b. The employer may need to assess the need for evidence of an employee’s qualified birth or adoption. Details needed to affect a hardship distribution may be a template for such evidence. Another possibility to gather such evidence may be the employer’s health insurance program, which requires evidence for “life events,” of which the birth or adoption of a child are common.
3. While it is expected that the IRS has begun working on guidance for these changes (notices, revenue procedures, technical corrections, and proposed regulations), employers may have to operate in good faith compliance now, with interpretations by ERISA counsel and their retirement plan committees to move forward at its discretion.

Surprises may come for employers that are not aware of the complexities involved in implementing these changes, particularly the LTPT employees rule and its mandatory nature. Similarly, surprises and complexities, which could involve additional paperwork, will be involved for voluntary changes if the qualified birth and adoption distributions are permitted.

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