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News and Insights for HR Executives, CFOs and Professional Administrators

Winter 2021

The Pandemic and Your Retirement Plan

Re-examine Plan Design in Light of COVID-19

The coronavirus pandemic has resulted in financial upheaval for a number of businesses that sponsor an employee retirement plan. As a result, some of them have taken a fresh look at their plan design to see if there are any changes that could help them better weather the financial storm.

Following are some areas of plan design that you might want to take a fresh look at.

Replace Safe Harbor with Discretionary Contributions

One plan design change that could be beneficial is to eliminate a safe harbor mandatory employer contribution and instead make matching employer contributions discretionary. This will give you more financial flexibility to deal with income disruptions your company might be facing due to the pandemic.

To recap: With a safe harbor plan design, you're required to contribute a minimum amount (usually 3 percent of salary) to participants' accounts each pay period. Participants then become fully vested in these matching contributions immediately. By adopting a safe harbor design, your plan doesn't have to pass annual non-discrimination tests, which may enable highly compensated employees (HCEs) to contribute more money to their accounts than they could otherwise.

IRS Notice 2020-52 states that plan sponsors can eliminate safe harbor 401(k) contributions for HCEs only and still retain the plan's safe harbor status as long as safe harbor contributions continue to be made for non-highly compensated employees. Therefore, you might consider suspending safe harbor contributions just for your HCEs if your finances allow this, which would enable you to retain the benefits offered by safe harbor status.

Re-examine Definition of Eligible Compensation

Sponsors often adopt a prototype plan with standard language regarding eligible compensation for deferrals and employer contributions, such as gross compensation with no exclusions. However, if your employees receive non-standard pay—such as bonuses, gift cards, and allowances—or non-cash stock compensation, this can cause problems.

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COVID-19 and Partial Plan Terminations

What You Should Know Now

Since the coronavirus pandemic began, many businesses have been forced to lay off and furlough employees in an effort to bring their workforce in line with reduced demand for products and services. Such downsizing can result in an unintended consequence that affects a business' qualified retirement plan known as a partial plan termination.

This occurs when there is a turnover rate of at least 20 percent of plan participants during the applicable period, which is usually defined as a single plan year. However, the applicable period can be longer than one plan year if the termination events are related—for example, if there is a series of related severances due to an event such as COVID-19 that occurs over more than one year (e.g., 2020 and 2021).

Plan Termination and Vesting

Upon a partial plan termination, affected plan participants must be 100 percent vested in their entire retirement account balance as of their termination date. This includes not only their own contributions and earnings, in which they are automatically 100 percent vested when contributed, but also employer matching contributions. These may have been subject to a vesting schedule that required employees to complete a certain number of years of service before they were fully vested in these funds.

Keep in mind that the 20 percent turnover rate threshold only creates a presumption that a partial plan termination has occurred. However, this presumption can be rebutted if the turnover is a routine part of business, such as with a seasonal business. Other factors that can rebut a presumption of termination include the following:

- Were the employees replaced?
- Did the employer have a bad motive, such as realizing a tax benefit for prefunding the plan?
- Were the terminations related to a major corporate event, such as a plant closing?

You can use Form 5300 to ask the IRS for a determination letter of whether a partial plan termination has occurred.

What About Furloughed Employees?

To avoid laying off employees during the pandemic, some businesses have furloughed employees instead. A furlough is essentially an unpaid leave of absence in which an individual remains an active employee.

Furloughed employees are generally not factored into the initial partial plan termination analysis. However, if they aren't brought back to work within a reasonable period of time, they should be considered terminated and counted when determining whether a partial plan termination has occurred.

You may consider amending your plan to count a certain amount of furlough time as hours of service that count for vesting purposes. This could help foster goodwill with affected employees because it won't result in lost vesting service for employees who eventually return to work from furlough.

What About Rehired Employees?

In a recent Q&A, the IRS answered a question about the impact of employees who are laid off due to COVID-19 and rehired before the end of 2020 on the partial plan termination calcula-

tion. These employees should generally not be considered to have had an employer-initiated severance from employment for the purposes of determining whether a partial plan termination occurred, according to the IRS.

Keep in mind, however, that a partial plan termination could still occur even if some laid-off employees are rehired before the end of 2020. This could be the case, for example, if the workforce reduction was part of a series of related severances over multiple years.

The details of partial plan terminations can be complex. Therefore, you should obtain professional guidance and counsel regarding questions you may have about partial termination of your qualified retirement plan.

Give us a call to discuss your plan's situation in more detail.

Partial Plan Termination Court Ruling

The issue of partial plan terminations was addressed in a court case in 2004, *Matz v. Household Int'l Tax Reduction Inv. Plan*. This case established four turnover rate categories:

1. If the turnover rate is less than 10 percent, there is conclusively no partial plan termination.
2. If the turnover rate is between 10 and 20 percent, there is a rebuttable presumption of no partial plan termination.
3. If the turnover rate is between 20 and 40 percent, there is a rebuttable presumption that a partial plan termination has occurred.
4. If the turnover rate is more than 40 percent, there is conclusively a partial plan termination.

Re-examine Plan Design

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While these forms of compensation are not excluded from the definition of eligible compensation, payroll administrators often exclude them in practice. This results in missed contributions and potentially costly corrective action by the plan sponsor.

Now would be a good time to take a close look at your plan's definition of eligible compensation for deferral. Make any changes in terms of including or excluding compensation that make sense for your employees and your plan.

Eliminate Waiting Periods and Vesting Schedules

It's no secret that employees tend to change jobs more often today than they did in the past. In fact, the average employee tenure at a job is about four years, according to the Bureau of Labor Statistics (BLS).

However, many plans still include vesting schedules for receiving employer matches that keep shorter-term employees from receiving the full amount of these matches. As a result, employees who change jobs frequently could end up losing thousands of dollars of matching funds and earnings over the course of their careers, which could significantly affect their retirement readiness.

For example, if a plan has six-year graded vesting and an employee leaves after two years, he will only be vested at 20 percent. If his employer match total is $2,000 when he leaves, he'll receive just $400 and forfeit $1,600.

Similarly, some retirement plans include waiting periods of up to six months before new employees are eligible to participate in the plan. Forcing new employees to wait this long before they can join a plan may discourage them from ever participating—even after they become eligible.

Given these trends, you may want to consider changing your plan design to eliminate waiting periods and vesting schedules to receive employer matches. More than one-third of plan sponsors are now offering immediate vesting of employer matching contributions, according to a survey conducted by the Plan Sponsor Council of America.

Add Auto-Enrollment and Auto-Escalation

These features have been proven to increase plan participation levels and boost employee deferrals. With auto-enrollment, new employees are automatically enrolled in the retirement plan when they're hired—they must opt out if they don't want to participate. And with auto-escalation, employees' contribution percentages are automatically increased each year—for example, by one percentage point until the deferral reaches 10 percent of pay.

Nearly one-third of employees who participate in a plan with auto-escalation contribute at least 10 percent of their pay to their plan, according to the Defined Contribution Institutional Investment Association. This compares to just one-fifth of employees who participate in a plan that doesn't feature auto-escalation.

Prepare for the Future

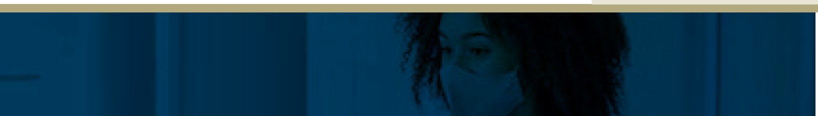
Plan now to meet with your governance group and third-party administrator to discuss whether you should make changes like these to your plan design in light of the pandemic or for any other reason. Doing so could better position your plan and your business for the future.

Deadline for Amending Retirement Plan to Reflect CARES and SECURE Act Changes

The Coronavirus Aid, Relief, and Economic Security (CARES) Act that was signed into law in the spring contained a number of provisions affecting qualified retirement plans. For example, qualified participants are able to take penalty-free distributions from their retirement accounts and borrow up to $100,000 from their plans in 2020. In addition, required minimum distributions (RMDs) from traditional IRAs and 401(k)s were suspended for 2020.

Given the urgency caused by the pandemic, sponsors were allowed to adopt these provisions right away without having to immediately adopt authorizing plan amendments. You have until December 31, 2022 (or until the end of the plan year that starts in 2022 for non-calendar year plans) to adopt plan amendments to reflect these changes.

The same deadline applies to adopting plan amendments to reflect retirement plan changes made as a result of the Setting Every Community Up for Retirement Enhancement (SECURE) Act that was passed at the end of 2019. For example, the SECURE Act requires that long-term, part-time employees be allowed to participate in 401(k) plans, effective for plan years beginning after December 31, 2020.



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Certified Public Accountants and Consultants
A Professional Corporation

200 East Carrillo, Suite 303
Santa Barbara, CA 93101
805-963-1837 Fax 805-564-2150

2021 ERISA Compliance and Reporting Deadlines

As an employee benefit plan sponsor, you are required to complete a variety of ERISA compliance tasks throughout the year. Your third-party administrator may be engaged to handle some of the tasks for the plan. Here are the 2021 plan year deadlines for some of the most common ERISA compliance tasks:

Task	Deadline
Send Form 1099-R to plan participants who received distributions in 2020	2/1/21
File Form 1099-R with the IRS to report distributions made in 2020 (if not filing electronically)	3/1/21
File Form 1099-R with the IRS to report distributions made in 2020 (if filing electronically)	3/31/21
Process corrective distributions for IRC Section 402(g) and ADP/ACP excesses without 10% excise tax	4/15/21
Process corrective distributions for failed ADP/ACP test from plan with EACA without 10% excise tax	6/30/21
File Form 5500 and Form 8955-SSA (without extension) or Form 5558 to request a two-and-one-half month extension	7/31/21
File Form 5530 to report and pay excise taxes on prohibited transactions and excess 401(k) plan contributions in 2020	7/31/21
Distribute Summary Annual Report (SAR) to plan participants (without Form 5500 extension)	9/30/21
File Form 5500 and Form 8955-SSA (with extension)	10/15/21
Send 2022 annual 401(k) safe harbor, automatic contribution arrangement, and qualified default investment alternative (QDIA) notices	12/1/21
Distribute Summary Annual Report (SAR) to plan participants (with Form 5500 extension)	12/15/21
Complete amendment to convert existing 401(k) plan design to safe harbor design or remove safe harbor status for 2022 plan year	12/31/21