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Employee Benefits Update September 30, 2020

IRS Guidance on New Retirement Plan Features Under the SECURE Act

Executive Summary

In recent months, most regulatory efforts affecting retirement plans have focused on COVID-19 relief, with scant attention to some of the changes introduced under the Setting Every Community Up for Retirement Enhancement Act (the "SECURE Act"), which was enacted at the end of 2019.

That changed on September 2, 2020, when the Internal Revenue Service (the "IRS") issued [Notice 2020-68], which provides guidance in the form of Q&As on the following SECURE Act changes, which are summarized in this Update:

- Penalty-free distributions for qualified birth or adoption expenses
- Participation of long-term, part-time employees in 401(k) plans
- Tax credit for small employers adding automatic enrollment features

Penalty-Free Qualified Birth or Adoption Distributions

Penalty-free withdrawals related to qualified births or adoptions became a feature that plan sponsors could add to a plan as of January 1, 2020 (although, in our experience, most plan recordkeepers have not yet established the systems support needed for them).

These distributions are limited to $5,000 per child, for each birth or adoption. Notice 2020-68 clarifies that an eligible adoptee must be either under age 18 or disabled per the strict tax code definition of "disability". Under this definition, an individual is considered disabled if he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to result in death or to be of long-continued and indefinite duration.

Absent actual knowledge to the contrary, a plan sponsor can rely on an employee's certification that they are eligible to receive this distribution. Moreover, the plan must permit the employee to repay the distribution, although the IRS has not yet issued guidance addressing the repayment rules.

Because the maximum amounts of these distributions are relatively modest and penalty-free, and they should not substantially impair a participant's retirement readiness, we anticipate that many plan sponsors will be interested in implementing this family-friendly change to their plan. If you are interested in exploring this new distribution option, we recommend coordinating with your plan recordkeeper to implement this change, because while you are permitted to implement this change operationally, plan amendments are not needed before the last day of your first plan year starting on or after January 1, 2022 (i.e., December 31, 2022 for calendar year plans).

Participation of Long-Term, Part-Time Employees in 401(k) Plans

Under the SECURE Act, part-time employees must be allowed to make elective deferrals to their employer's 401(k) plan after attaining age 21 and completing at least 500 hours of service during three consecutive 12-month periods.

Notice 2020-68 clarifies that 12-month periods beginning before 2021 can be disregarded for purposes of applying the deferral eligibility rule—so this will not have an immediate impact on the operations of a 401(k) plan; however, the Notice also specifies that these earlier periods cannot be disregarded for vesting purposes.

The IRS is accepting comments regarding counting pre-2021 service by part-time employees. All comments are requested by November 2, 2020.

Small Employer Automatic Enrollment Tax Credit

In an effort to encourage smaller employers to implement retirement plans for their workers, the SECURE Act establishes a new tax credit of $500 annually, for up to three years, if an eligible small employer offers an eligible automatic contribution arrangement (EACA) in a qualified retirement plan. In order to be eligible, the employer must have had no more than 100 employees who are paid at least $5,000 per year during the preceding year. The tax credit is available only when the employer first includes an EACA in any qualified retirement plan, and the employer must generally maintain the same EACA in the same plan for all three tax years in order to receive the full $1,500 tax credit.

To discuss any of the guidance addressed in this Employee Benefits Update, or any other employee benefits matters, please contact any member of our Employee Benefits and Executive Compensation Group below.

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