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Client Alert

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# Administering a 401(k) Plan in the Age of COVID-19

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Under the best of circumstances, administering a 401(k) plan is a challenge for any plan sponsor. The Age of COVID-19 requires considering additional pressing issues along with the typical participant deferrals and fiduciary concerns. In the following, our employee benefits group provides brief responses to questions frequently raised by Shumaker's clients when reacting to recent events.

***How may the Plan Sponsor eliminate or suspend employer matching contributions?***

*Regular Matching Contributions* – Reducing or eliminating employer matching contributions is a plan sponsor business decision and not a fiduciary decision. To reduce or suspend the employer matching contributions, the terms of the plan must permit such an amendment. The amendment may be adopted at any time, and thereafter, future matching contributions on salary deferrals will be suspended or reduced. The information regarding the change must be distributed to affected participants as a summary of material modifications, updating the summary plan description.

*Safe Harbor Matching Contributions* – If the plan is a safe harbor 401(k) plan, in addition to the above requirements, amending such plan mid-year to reduce or eliminate the safe harbor matching contributions will depend upon the plan's annual safe harbor notice language (typically sent at the end of the preceding calendar year).

1) If the annual safe harbor notice included language permitting the plan sponsor to reduce or suspend matching contributions mid-year, the plan may be amended in that manner.

2) If the annual safe harbor notice did **not** contain this language, the plan sponsor must be able to demonstrate that it is operating at an economic loss at the time of amendment in order to change the safe harbor matching contributions mid-year.

Under either of the above circumstances, affected participants must be provided with a supplemental 30-day notice explaining (i) the consequences of the reduced or suspended safe harbor matching contributions, (ii) the procedure to change an employee's salary deferral contribution election, and (iii) the effective date of the plan amendment. Following this notice, the employer must fund the safe harbor contributions through the effective date of the plan amendment or 30 days after the notice is provided, whichever is later. For example, an employer can make the change effective June 1 by providing the notice to employees on May 2.

***NOTE - following the suspension of a safe harbor contribution, the annual actual contribution percentage ("ACP") test and actual deferral percentage ("ADP") test must be performed based upon the entire plan year using the current year testing method.***

***How may the Plan Sponsor eliminate or suspend employer non-elective contributions?***

*Regular Profit Sharing or Non-Elective Contributions* – Same requirements as for regular matching contributions as defined above.

*Safe Harbor Non-elective Contributions* – Same requirements as for employer safe harbor matching contributions, except that the 30-day notice does not have to discuss the procedure to change the employees' deferral/contribution elections. Annual nondiscrimination testing is required for ACP and (perhaps) ADP over the entire plan year.

***What happens when a participant has reduced hours or is terminated?***

If an employee's hours are reduced due to a furlough, layoff, or termination, such employee may no longer meet the plan definition of an eligible participant. Note that the employee may be paid for this time through the special government program recently set in place for the COVID-19 employment disruption. However, for purposes of participating in a 401(k) plan, the funds received from the safety net programs do not translate as hours of service for the employee.

If a substantial percentage of plan participants are not brought back to work in the calendar year, there may be a partial termination of the plan, which could fully vest all affected participants, including those who voluntarily terminated. In other words, having a large number of terminated or indefinitely furloughed participants in 2020 may require full vesting for these and other participants. Although a partial termination is based on the circumstances of the terminations, if 20 percent or more of the workforce terminates for any reason within a three-year period, a partial termination may be deemed and create full vesting for all affected participants.

***What happens when the employee picks up hours again or is re-employed later in 2020?***

A re-employed participant will resume the participation in 2020 without a break. Most plans are designed so that the return would re-establish participation without a waiting period, looking thereafter to the service requirements for contributions and deferrals.

***May a retained employee reduce or eliminate future salary deferrals?***

With typical plan terms, an employee may reduce or eliminate their salary deferrals at any time during any plan year. If this occurs in a 401(k) plan which does not use the safe harbor plan method (see earlier), reduced salary deferrals by non-highly compensated employees will adversely affect the ADP testing for the plan in 2020. This also is true of the deferred contributions that are not matched, potentially creating another failure of the ACP test for 2020. Encouraging employees to continue elective deferrals to the plan may prevent ADP and ACP test failures.

***When do 401(k) plan's break-in-service rules become important?***

Whether a break in service occurs following a layoff, furlough, or termination in a plan year depends upon the plan terms. However, in the case of rehired participants in 2020, such participants typically would resume qualifying employment without having a 2020 break in service, although there could be vesting or funding implications.

**SPECIAL RULES APPLYING UNDER THE RECENT FEDERAL LEGISLATION**

The Coronavirus, Aid, Relief, and Economic Security Act (CARES Act) was signed on March 27, 2020, and offers qualifying plan participants relief from certain 401(k) plan restrictions and requirements, including those in-service distributions, plan loans, and required minimum distributions.

*In-service distributions permitted.*

Under the CARES Act, a 401(k) plan participant may receive a "coronavirus-related distribution" during the period January 1, 2020, and before December 31, 2020, even if the participant remains actively employed, if,

1. The participant, or the participant's spouse or dependent, is diagnosed with the coronavirus by a medically-approved test; or

2. Such individual has adverse financial consequences due to the virus, such as (i) being quarantined; (ii) being laid off or furloughed; (iii) receiving reduced working hours; (iv) being unable to work scheduled hours because of child care needs; or (v) closing or reducing hours of a business owned or operated by the affected individual.

These distributions are not subject to the 10 percent early distribution penalty for participants and are exempt from the mandatory 20 percent withholding on the distribution. Importantly, the federal income tax liability related to the distributions may be spread over a three-year period, or the participant can avoid the tax liability entirely by recontributing the distribution to the plan within three years. The CARES Act distributions may not exceed $100,000 across all qualified plans. The employer can rely on a participant's certification that they satisfy the required conditions.

***Plan Loan Changes.***

401(k) plans which permit loans from a participant's account receive two expansions under the CARES Act.

1) Increased Loan Limits: The amount of a plan loan for a qualified individual (one meeting the above CARES Act distribution circumstances) may be increased to the lesser of (i) $100,000 (increased from $50,000), or (ii) the greater of $10,000 or 100 percent of the present value of the participant's vested account balance (increased from 50 percent). The larger amounts are available only for loans made during the 180-day period beginning on March 27, 2020.

2) Delayed Loan Repayments: All 2020 loan payments (due on either a CARES loan or any other outstanding loan) may be delayed by one year, during which interest will accrue. The delay is disregarded for purposes of the five-year maximum limit on participant loan repayment periods.

***Required Minimum Distribution Changes.***

For 2020, all required minimum distributions may be waived for defined contribution plan types, including 401(k) plans, and also for individual retirement accounts. This also applies to RMDs due in 2020 but attributable to 2019.

***How do the regular hardship distributions apply?***

The CARES Act special in-service distribution opportunity applies to all defined contribution plans. Otherwise, unless the plan offers hardship distributions and a participant is facing eviction or one of the other reasons for receiving a hardship distribution, the reduction in hours does not automatically trigger the ability to receive an in-service distribution.

**These CARES-related options are available immediately provided the plan is amended to add the provisions by the last day of the plan year beginning after January 1, 2022 (i.e., December 31, 2022, for calendar year plans).**

Please do not hesitate to contact Jim Culbreth at jculbreth@shumaker.com or 704.945.2186, Eric Britton at ebritton@shumaker.com or 419.321.1348, or John Burgess at jburgess@shumaker.com or 813.227.2260 if you have questions.

For the most up-to-date legal and legislative information related to the coronavirus pandemic, please visit our Shumaker COVID-19 Client Resource Center at shumaker.com. We have also established a 24/7 Legal & Legislative Helpline at 1.800.427.1493 monitored by Shumaker lawyers around the clock.