COVID-19: COVID-19 CONSIDERATIONS: EMPLOYER SPONSORED RETIREMENT PLANS

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U.S. Benefits, ESOPs, and Executive Compensation Alert

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In the wake of the COVID-19 pandemic and the resulting economic uncertainty, many employers and employees alike are searching for ways to be financially prepared in the weeks and months to come. This article highlights some things employers may wish to keep in mind when making decisions with respect to their employer-sponsored retirement plans.

FURLOUGHS OR LAYOFFS OF EMPLOYEES COULD TRIGGER 100 PERCENT VESTING OF 401(K) PLAN ACCOUNTS.

Per the Internal Revenue Code of 1986, as amended (the “Code”), when a 401(k) retirement plan is deemed to be “partially terminated” all participants who have been affected by the partial termination and who are not yet fully vested in their plan benefits must become fully vested. A plan is deemed to be partially terminated based on the specific facts and circumstances of a particular case, including whether a group of employees who have previously been covered by the plan are now excluded from the plan due to severance. The Internal Revenue Service has ruled that, generally speaking, a reduction in force that results in the termination of 20 percent or more of the total number of plan participants will be presumed to be a partial termination of the plan. Based on the specific facts and circumstances, a broad-based furlough could likewise result in a partial termination, depending on the length of the furlough and the method used by the plan to measure vesting service.

What to Keep in Mind: Employers that are considering or have chosen to layoff or furlough a number of employees in light of COVID-19 should consider whether the layoff or furlough could cause employer contributions to employees' 401(k) accounts to immediately vest.

DEFAULT OF PLAN LOANS MAY BE TRIGGERED BY EMPLOYEE TERMINATIONS.

Many qualified employer plans, including 401(k) plans, permit plan participants to obtain loans from their plan accounts, providing them with access to cash on a tax-free basis to be repaid over time, typically through payroll deductions. Depending on the plan's provisions, outstanding plan loans may be designed to accelerate the entire remaining principal and interest upon a participant's termination of employment, meaning that participants with outstanding loans who are terminated may be required to repay their entire outstanding loan balance or risk defaulting on the loan. A defaulted plan loan results in an immediate deemed distribution of the unpaid portion of the loan. A deemed distribution is subject to ordinary income tax in the same manner as any other distribution (including a possible 10 percent penalty for early distributions) from the plan and may not be rolled over to

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another eligible retirement plan or IRA. (Newly available COVID-19-related relief from plan loan repayments otherwise due in 2020 discussed below.)

What to Keep in Mind: Employers should be aware that employees with outstanding plan loans may default on the loans if terminated in a reduction in force or furlough, which would cause the employee to incur federal income and state income tax. Employers should also consider whether changes to the plan's loan procedures are appropriate to prevent employees from automatically defaulting on their loans, such as by allowing loans to continue to be repaid while on layoff or furlough (to the extent that an employee has sufficient funds to make repayments on the loan).

HARDSHIP WITHDRAWALS MAY BE AVAILABLE IN LIGHT OF COVID-19.

Most 401(k) and other defined contribution plans allow participants to make an in-service withdrawal from the plan if they are experiencing financial hardship. To qualify, the participant must have a "hardship" and the distribution must be necessary to meet the financial need created by the hardship. Some of the financial hardships that a participant can experience due to COVID-19-related circumstances that would qualify for a hardship distribution under safe harbor rules include: (1) expenses for (or necessary to obtain) medical care that would be deductible under Code § 213(d); (2) tuition, related educational fees, or room and board expenses for post-secondary education; (3) expenses needed to prevent eviction from or foreclosure on a principal residence; or (4) burial or funeral expenses for a deceased parent, spouse, children, or dependents. (COVID-19-related distribution discussed below.)

What to Keep in Mind: Employers should consider whether their plan permits hardship distributions that would allow employees to receive hardship distributions in light of circumstances created by COVID-19. (Newly available COVID-19-related distribution, 10 percent penalty relief discussed below.)

TAX-FILING/PAYMENT EXTENSIONS.

IRS Notice 2020-18 extends the deadline for tax return filings and payments due on April 15, 2020, (but not any other date) to July 15, 2020. No separate or additional forms need to be filed with any government agency to take advantage of the extended filing and payment deadline. A recent IRS FAQ, "Filing and Payment Deadlines Questions and Answers," clarifies that this extension affects the following employee benefit deadlines:

- Extends the deadline for making required qualified retirement plan contributions for the 2019 plan year to July 15, 2020.
- Extends the deadline for making 2019 IRA contributions to July 15, 2020.
- Extends the deadline for employees to pay the 10 percent% additional tax on early distributions (before age 59½) from a retirement plan or IRA to July 15, 2020.

What to Keep in Mind: Employers that need additional time to make their 2019 required qualified defined contribution retirement plan contributions should consider taking advantage of the extended deadlines. (Special defined benefit plan funding relief is discussed below.) Employers opting to take advantage of the extended deadlines should ensure that the terms of their plan do not require that contributions be made by a specific date.

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THE CARES ACT PROVIDES FOR COVID-19-RELATED DISTRIBUTIONS, 10% ADDITIONAL TAX RELIEF FOR EARLY DISTRIBUTIONS, AND ENHANCED PLAN LOANS.

The Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"), signed into law on March 27, 2020, creates a COVID-19-related distribution option for qualifying individuals participating in certain tax-advantaged retirement plans. Participants may now take COVID-19-related distributions up to $100,000 before December 31, 2020, without incurring the otherwise applicable 10 percent additional tax penalty on early distributions. The CARES Act also increased the plan loan limit applicable to tax-advantaged retirement plans to $100,000 or 100 percent of a participant's vested account balance and postpones for one year the repayment of plan loans due before December 31, 2020. For more information on these provisions, please see K&L Gates Alert,

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. Whether the postponement of loan repayments is mandatory or optional is up for debate.

What to Keep in Mind: Employers can help employees in need of additional liquidity due to COVID-19-related circumstances by allowing them to access retirement plan funds through a new COVID-19-related distribution option without incurring a 10 percent additional tax or by allowing them to take a higher-limit plan loan, as well as delay repayment of plan loans otherwise due before the calendar year end. Some employers are concerned that workers using the CARES Act withdrawal and loan relief could harm their retirement security and are offering enhanced education and planning tools to help participants balance their immediate and long term financial needs.

THE CARES ACT PROVIDES FUNDING RELIEF TO SPONSORS OF DEFINED BENEFIT PLANS.

The CARES Act includes two provisions that grant relief to employers sponsoring defined benefit plans with respect to funding. First, the CARES Act postpones the due date of any minimum required contribution payment owed in 2020 until January 1, 2021, although any payment made after its otherwise applicable due date must be paid with interest. Second, to prevent benefit restrictions from being triggered in 2020 due to funding deficits, the CARES Act provides that funding thresholds may be determined by reference to the plan's funding status for the 2019 plan year. For additional information on the CARES Act, please see another K&L Gates Alert, entitled

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What to Keep in Mind: Employers who maintain a tax-qualified defined benefit plan may be able to delay or reduce their current funding obligations under the CARES Act.

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