401(k) Plan Issues in the Current Environment

Practical and Legal Considerations

By Sheldon M. Geller

This article is intended to address 401(k) plan issues and concerns that develop during periods of economic uncertainty and market volatility, such as the current coronavirus (COVID-19) pandemic. The author endeavors to keep CPAs informed of the types of practical problems and legal challenges likely to occur in the current environment.

Proper Plan Governance

Plan sponsors must heighten fiduciary governance and continue to implement best practices during these stressful times, as plan participants are more likely to challenge what they may view as debatable practices or operational errors. The greater the economic uncertainty, the greater the risk of litigation and claims; it is important to maintain vigilant oversight and attend to any operational concerns.

The Department of Labor's (DOL) position is that plan fiduciaries must adopt and adhere to routine procedures, receiving advisor reports at least annually, without qualification. Accordingly, plan sponsors must continue to engage in robust procedural prudence, apply investment policy criteria, and prepare detailed meeting minutes to document fiduciary decisions.

Plan sponsors must also continue to implement best practices, strengthen internal controls, and manage plan governance. Indeed, legal counsel encourage plan sponsors to retain an independent fiduciary advisor and seek and evaluate their advice to avoid claims of imprudent fund selection, excessive fees, self-dealing, and flawed fiduciary decision making.

Partial Plan Termination

If the plan sponsor terminates many employees, a plan may suffer a partial plan termination and therefore be required to fully and immediately vest affected participant accounts. In general, the IRS deems a partial termination to have occurred if 20% of total plan participants (excluding former employees with account balances) are terminated for reasons other than routine annual turnover. The employer-initiated severance includes any severance from employment not attributable to death, disability, or retirement on or after normal retirement age. Employer-initiated severance also includes events outside the employer's control, such as depressed economic conditions. Accordingly, a 20% reduction in total plan participants due to COVID-19 may in fact trigger a partial termination.

The 20% test creates a presumption that the plan has suffered a partial termination, which may be rebutted if the facts and circumstances demonstrate that the plan did not suffer a partial termination. Therefore, it is advisable for plan sponsors to wait until year-end to determine whether their plan has suffered a partial termination if they intend to rehire terminated employees later in the year. It is advisable to document the facts and circumstances surrounding the workforce reduction as well as the rehiring of terminated employees.

Suspending Safe Harbor Nonelective or Matching Employer Contributions

Plan sponsors may suspend safe harbor contributions midyear if the plan provides a 30-day notice prior to the beginning of the plan year notifying participants that the safe harbor contribution may be suspended during the plan year (a "maybe notice") or if the plan sponsor is operating at an economic loss for the plan year. The plan sponsor would need to provide a 30-day supplemental notice in advance of the suspension, make safe harbor employer contributions from the beginning of the plan year to the suspension effective date, conduct the annual nondiscrimination test, and make a top-heavy minimum contribution, if applicable.

If the plan had a 3.0% nonelective safe harbor employer contribution provision and suspension was based on the maybe notice, then the plan sponsor may reactivate the safe harbor contribution later in the year, provided the plan sponsor makes the contribution

for the entire plan year and amends the plan to reinstate the safe harbor at least 30 days before the plan year ends. If the plan is amended later than 30 days before its year-end, then the required safe harbor contribution is increased to 4.0% of compensation.

Plan sponsors may not reactivate a safe harbor matching employer contribution provision later in the year.

A plan could lose its tax-qualified status if safe harbor contributions are suspended during a plan year and the IRS determines that all requirements were not met. The employer may also be at risk of being found to have engaged in a prohibited transaction or fiduciary breach by not making its required contribution.

Suspending Nondiscretionary Nonelective or Matching Employer Contributions

Plan sponsors may amend their plans to suspend a nondiscretionary nonelective employer contribution or a nondiscretionary matching employer contribution required under the governing plan document to the extent that participants have not satisfied the plan's allocation formula (e.g., completing 1,000 hours of service, being employed on the last day of the plan year).

Once participants satisfy the condition precedent for a required contribution, they have accrued a nonforfeitable right to an employer contribution allocation. If so, the plan sponsor should adopt an amendment with a prospective effective date to avoid a cutback in accrued benefits.

Suspending Discretionary Nonelective or Matching Employer Contributions

Plan sponsors may resolve not to make a discretionary nonelective employer contribution or discretionary matching employer contribution at any time. If a plan sponsor funds a discretionary matching contribution each payroll period, it may prospectively suspend the matching contribution. Even if the plan sponsor announces a discretionary matching contribution at the beginning of the plan year and funds the matching contribution each payroll period, the plan sponsor may suspend the matching contribution prospectively.

It is advisable to provide written notice to employees in advance of the effective date for the suspension of a discretionary matching contribution funded each payroll period, with a reference to the effect that employees have a reasonable opportunity prior to the suspension to modify their deferral elections.

Paycheck Protection Program

The Paycheck Protection Program (PPP), including the forgiveness amount, is intended to provide economic relief to small businesses adversely impacted by COVID-19. The question as to whether an employer contribution to a qualified 401(k) retirement plan meets the criteria for PPP forgiveness is based upon the interim final rule issued by the U.S. Small Business Administration.

> Many employers have taken steps to give plan participants access to their 401(k) accounts by way of the CARES Act and other types of plan distributions and participant loans.

It appears that an employer can take into account an employer contribution to a qualified 401(k) retirement plan as a payroll cost in its forgiveness amount calculation, subject to the following:

- The eligible loan amount calculation takes into account an employer contribution less any amount attributable to annual cash compensation to employees or owners in excess of $100,000.
- The forgiveness amount calculation takes into account an employer contribution less any amount attributable to annual cash compensation paid to employees or owners in excess of $100,000.
- The employer contribution takes into account only cash compensation paid to employees or owners whose principal place of residence is in the United States.
- The employer contribution is incurred during the covered eight-week period compared to the previous year or time period proportionate to maintaining employees and compensation (not in excess of $100,000).

The full principal amount of the loan and any accrued interest may qualify for loan forgiveness if the borrower uses all of the loan proceeds for forgivable purposes—that is, to maintain or rehire staff and maintain compensation levels. No more than 25% of the loan forgiveness amount, however, may be attributable to nonpayroll costs. The Coronavirus Aid, Relief, and Economic Security (CARES) Act permits the PPP's forgivable loan to pay for up to eight weeks of payroll costs, including any retirement benefits.

Plan Amendments, Employee Notices, and Written Procedures

The long-term prospects for the economy remain uncertain, and the immediate short-term impact upon plan participants is significant. Many employers have taken steps to give plan participants access to their 401(k) accounts by way of the CARES Act and other types of plan distributions and participant loans.

Plan sponsors must make certain that they execute plan amendments, distribute employee notices, and adopt written procedures in connection with any modifications they make to their 401(k) retirement plans. They should also seek competent advice in order to make informed decisions relating to the management of their 401(k) plans and to help their plan participants endure, if not succeed, in these challenging economic times. ❑

Sheldon M. Geller, JD, CPA, *is the president and managing member of Stone Hill Fiduciary Management, LLC, Great Neck, N.Y. He is a member of* The CPA Journal *Editorial Advisory Board.*