COVID-19 Relief Packages Require Action

What Plan Sponsors Need to Know About Changes to Their Retirement Plans and Paid Leave Programs

Revised as of April 3, 2020

Key Retirement Plan Issues in Coronavirus Aid, Relief, and Economic Security (CARES) Act—Plans Need to Review Now:

Plans **may elect** to allow expanded distributions and loans to assist participants. **Some** record-keepers are adopting these changes **automatically** unless the plan affirmatively tells them to stop. Retroactive amendments permitted until 2022.

Elective Distribution and Loan Rules:

- Coronavirus-Related Distributions are those made in 2020, up to $100,000 (aggregate across plans) from 401(k), 403(b) or IRAs
- No 10% penalty for distributions < age 59½
- Taxed over three years, no withholding
- Can repay over three years instead
- Coronavirus-related loans permitted up to $100,000, or to the total vested account balance if lower (includes any existing loans)
- Loan payments between 3/27/20 and 12/31/20 may be delayed for one year, but interest still accrues. Remaining payments re-amortized, but year delay will not cause a loan to exceed maximum period (5 yrs. for non-home loans).
- Eligibility for both: participant (or spouse or dependent) diagnosed with disease, OR may self-certify he/she suffered adverse financial consequences due to effects of virus.

Defined Contribution (DC) Plans MAY suspend RMDs in 2020: DC plans may be retroactively amended to permit participants to suspend receipt of RMDs in 2020.

Defined Benefit (DB) Plan Funding Relief: DB plans may use 2019 AFTAP for 2020; can delay minimum required contributions until 1/1/2021 (with interest).

As state and local governments ordered most businesses to stop or reduce operations in March, the economy ground to a near halt. Facing the reality of hundreds of thousands of businesses shuttered and millions of people with no paychecks, Congress began passing a series of relief packages (three as of this writing, ending with the CARES Act). Collectively, these addressed a host of issues, from hospital assistance to industry bailouts to paid leave to borrowing from 401(k) plans... and there may be more aid packages to come.

Here we're going to focus just on two key sets of issues facing plan sponsors—changes affecting their retirement plans, and changes affecting their employee leave programs and related taxes and loans. Immediate review and action are needed for both.

Retirement Plans Have Some Decisions to Make Right Now:

Recognizing that millions of Americans may need to tap into their savings to offset loss of income in the near term, Congress expanded both distribution options and loan options for defined contribution plans. On the opposite side of that coin, Congress also recognized that Required Minimum Distributions for those over 72 could lock in losses in the current financial markets, and that defined benefit plans would face funding issues. To address all of these, Congress passed a number of retirement provisions that plan sponsors MAY ELECT to take advantage of…or not.

Plan Sponsors Must Make a Choice (and Some Record-keepers are Using Negative Consent to Implement Changes Already):

The key word here is elect—plan sponsors have to choose to adopt these newly permissible plan features to make them accessible to their plan participants. However, at least one major record-keeper has already notified many plan clients that the record-keeper will adopt the loan and distribution changes right away unless the plan sponsor affirmatively says "no." Plan sponsors need to review these communications and make their own decisions about how to proceed. For example, employers who are closed down or operating at reduced capacity may want these options for their workers. But other employers who are not laying off or furloughing workers may not see a need to run the risk of increased plan leakage in the long run from loan defaults and distributions.

Either way, plan sponsors need to make sure they don't "accidently" adopt these changes by ignoring notices from their record-keepers—done properly, the plan can be deemed to have adopted a change proposed through a negative consent notice process in which a failure to object is acceptance.

Settlor vs. Fiduciary Decisions:

It is important to note that these plan design decisions are not fiduciary decisions, but "settlor" decisions. In other words, the company decides what benefits to offer in its plan as an employer, not as a plan fiduciary. The fiduciary role comes into play in implementing those corporate decisions. That also means that the company, not the plan, should pay for any expenses related to considering these issues.

To ease implementation, the law gives plan sponsors until 2022 to adopt retroactive plan amendments. However, plans need to touch base with their record-keepers right away, as properly administering the expanded loan and distribution provisions (if adopted) is a fiduciary function.

What are the Expanded Options for Distributions, Loans, Required Minimum Distributions, and DB Plan Funding?

Distributions:

The CARES Act provides a new distribution option that is available for all participants, including current, in-service employees who are under 59½. The new "Coronavirus-Related Distribution" must be made in 2020; come from a 401(k) or 403(b) plan or an IRA; and can be for an amount up to $100,000. This limit is aggregated across all plans in a control group. A participant is eligible for a Coronavirus-Related Distribution if the participant, spouse or dependent is diagnosed with COVID-19, or if the participant experiences adverse financial consequences stemming from COVID-19 as a result of being quarantined, furloughed, laid off, having reduced work hours, being unable to work due to lack of child care, the closing or reduction of hours of a business owned or operated by the individual, or other factors as determined by the Treasury Department. The participant may self-certify to the plan that he or she meets these qualifications, and the plan may rely on that certification, simplifying plan administration considerably.

There is no 10% early withdrawal penalty for people under age 59½, there is no required withholding, and the tax on the distribution is spread over three years, not just in 2020. Alternatively, the participant can repay the distribution as a rollover contribution over three years. For plans that permit hardship withdrawals, this is clearly a much more advantageous situation for the participant.

Employer Paid Leave, Tax Credit and Payroll Loan Issues:

Families First Coronavirus Response Act ("FFCRA"):

- Applies to employers with <500 employees, from April 1 through December 31, 2020.
- Requires up to 2 weeks of paid sick leave: (1) at regular pay (max $511 per day/$5,110 total) if employee is quarantined, or symptomatic and seeking a diagnosis; or (2) at two-thirds regular pay (max $200 per day/$2,000 total) if caring for children or a quarantined individual.
- Requires up to 10 weeks of additional paid FMLA to care for children at two-thirds pay ($200 per day/$10,000 total) for employees with more than 30 days of service in the last 60 days.
- Employers <50 employees may not have to provide paid leave for childcare if it would jeopardize viability of the business as an ongoing concern as defined in new DOL regulations.

Tax Credits:

- Dollar-for-dollar offset against quarterly payroll taxes for FFCRA qualifying wages above.
- Additional 50% tax credit against payroll taxes on wages up to $10,000 in quarter available (1) if business fully or partially suspended due to government orders, or (2) gross receipts in first quarter down 50% (80% in subsequent quarters) compared to last year. Not available if using Paycheck Protection loan below.

Paycheck Protection Program Loans:

- Employers <500 employees may apply for Small Business Administration-backed loans to meet payroll and other expenses.
- Loans available 4/3-6/30, no fees or collateral, and payments can be deferred for six months.
- Loans are forgiven if 75% of loan is used for payroll costs and all employees are kept on or rehired for eight weeks.

Participant Loans:

The expanded loan provisions essentially eliminate the 50% collateral requirement, permitting the participant to borrow up to $100,000 or the full amount in the participant's account balance if less than $100,000. This limit does take into account any existing loans (i.e. the participant has already borrowed $20,000, so the new limit would be an additional $80,000). Further, any loan payments due between March 27 and December 31, 2020 may be delayed for one year, but interest will still accrue. The loan will be re-amortized in 2021 to reflect the accrued interest, but the delay will not result in the loan otherwise being treated as extending beyond the maximum repayment period (typically five years, except for home loans). The expanded loan provisions have the same participant eligibility requirements as the new distribution options, but the new legislative text does not make it clear that the plan can rely on participant self-certification for loans (that is likely the intention—Treasury may provide additional guidance).

Plan sponsors should take care in implementing these special retirement plan loan rules, and keep an eye out for Treasury or IRS guidance. In particular, the delayed repayment rule may create recordkeeping and participant communication challenges and should be coordinated with any rules a plan has regarding when a loan is considered in default, triggering a deemed distribution required to be included in the participant's taxable income.

Required Minimum Distribution ("RMD") Option: Defined Contribution plans—including 401(k), 403(b) and 457(b) governmental plans—may permit participants to suspend receipt of RMDs that were otherwise required to be made in 2020, including by those who reached their "required beginning date" during 2019. For years after 2020, an individual's required beginning date and the distribution periods applicable to beneficiaries should be determined without counting 2020.

2020 Funding Relief for Defined Benefit Plans: Recognizing the (hopefully) short-term drop in the financial markets will affect the funding status of defined benefit plans, and that many companies will have some liquidity issues when the required minimum payments for 2020 are due, Congress made two important changes for defined benefit plans. First, minimum required contributions are now not due until January 1, 2021 (but interest will accrue from the original due date, typically 8½ months after the end of the plan year.) Second, the defined benefit plan's Adjusted Funding Target Attainment Percentage (AFTAP) for 2019 can be used again for 2020.

Plan Sponsors Must Make Non-Plan Employee Decisions Right Now, Too—Paid Leave, Tax Credits and Paycheck Protection Loans for Small Businesses:

To try to keep the economy from collapsing during the "isolation" phase of the pandemic, Congress tried to do two contradictory things at the same time. First, they wanted to keep paychecks coming to workers who can't work. Second, they wanted businesses to survive while paying workers even though the businesses may be closed or reducing operations. The result is a combination of new leave mandates, tax relief and loans for employers. (While we are focusing on leave issues facing small employers here, obviously the stimulus packages do much, much more—employers should work with counsel and other professionals to evaluate the full range of options the new laws present).

The Families First Coronavirus Response Act (FFCRA) Paid Leave Mandate:
Starting April 1, 2020 through the end of the year, private employers with fewer than 500 workers (including full and part time workers, counted on the day leave is taken by each employee) must provide new paid sick leave benefits and expanded Family and Medical Leave Act paid benefits in relation to the COVID-19 pandemic. The DOL's Wage and Hour Division developed posters (available on its website) that employers must display in their workplaces describing these new rights—DOL has adopted a 30 day non-enforcement policy (essentially, the month of April) during which employers can adopt these changes without penalty if operating in good faith.

Specifically, employers must provide two weeks (up to 80 hours) of paid sick leave:

1. at the employee's regular rate of pay (capped at $511 per day and $5,110 for the two weeks) where the employee is unable to work because the employee is quarantined (pursuant to Federal, State, or local government order or advice of a health care provider), or experiencing COVID-19 symptoms and seeking a medical diagnosis; or
2. at two-thirds of the employee's regular rate of pay (capped at $200 per day or $2,000 for the two weeks) where the employee is unable to work because of a bona fide need to care for an individual subject to quarantine, or to care for a child (under 18 years of age) whose school or child care provider is closed or unavailable for reasons related to COVID-19, or experience similar conditions defined in as yet unreleased guidance from the Departments of Health and Human Services, Treasury and Labor.

Further, the employer must provide up to an additional 10 weeks of paid expanded family and medical leave at two-thirds the employee's regular rate of pay (capped at $200 per day, or $10,000 for the 10 weeks) where an employee is unable to work due to child care. Employees must have worked 30 days within the past 60 days to be eligible for the expanded FMLA benefits.

Small businesses with fewer than 50 employees may qualify for exemption from the requirement to provide leave due to school closings or child care unavailability if the leave requirements would jeopardize the viability of the business as a going concern. DOL issued temporary regulations that require an authorized officer of the business to conclude (and keep documentation of the conclusion) that:

1. providing the paid child care leave would result in "expenses and financial obligations exceeding available business revenues and cause the small business to cease operating at a minimal capacity;"

2. the absence of the employees seeking the leave "would entail a substantial risk to the financial health or operational capabilities of the business because of their specialized skills, knowledge of the business, or responsibilities;" or
3. there are not sufficient workers who could replace the employees seeking the leave to keep operating at a minimal capacity.

Payroll Tax Relief for Employers:
To make it possible for employers to meet these mandates, the law provides for several new tax credits. (Again, there are many other tax provisions applicable to employers in the stimulus packages—we are just addressing those related to payroll issues here).

FFCRA Tax Credit: In order to pay for the temporary paid sick leave and expanded FMLA benefits, the employer may offset quarterly payroll taxes that would otherwise be due to the IRS dollar-for-dollar against the costs of the new qualified leave expenses (an employer retention credit). Additional guidance is anticipated from the Treasury Department to account for the health benefit costs associated with such workers.

Employee Retention Tax Credit: The CARES Act provides a new, additional payroll tax credit equal to 50% of qualified wages paid to employees between March 13 and December 31, 2020. Also a retention credit (the employer reduces the amount it would otherwise send to the IRS for its quarterly payment) it is available to employers (1) who fully or partially suspend operations due to orders from a government agency due to COVID-19 or (2) who see gross receipts for a given calendar quarter decline by more than 50% compared to the corresponding quarter in the previous year (and 80% in subsequent quarters). The credit is capped at $5,000 per employee. The credit is reduced by any FFCRA credit taken, and is not available to a business that takes a Paycheck Protection Program Loan discussed below.

Paycheck Protection Program Loans Backed by the Small Business Administration ("SBA"):
While the CARES Act provides many hundreds of billions in loans to various industries, and to large and mid-size business, the Paycheck Protection Program loans are for small businesses with less than 500 employees and are specifically intended to help those business pay workers during the pandemic. Backed by the SBA, the loans are available from various commercial vendors for a limited period of time. The favorable terms include no fees, no collateral, six months of deferred payments and a forgiveness of the loan if it is used for certain purposes.

Specifically, the loans will be forgiven if all employees are retained or rehired for at least eight weeks and 75% of the proceeds are used for payroll costs. Payroll costs are defined to include salary, wages and commission; tips; vacation, parental, family, medical or sick leave pay; severance allowances; health care benefits, including insurance premiums; retirement benefits; and all state and local taxes assessed on employee compensation. The remaining 25% may be used for mortgage obligations, rent, utilities and interest on any other previously-incurred debt obligations.

Conclusion:

Plan sponsors need to review these changes and act quickly to comply with new requirements and to take advantage of new opportunities. Given the speed at which Congress passed these relief bills, it is inevitable that there will be many questions and problems throughout their implementation. Plan sponsors and their service providers should pay close attention to guidance from the U.S. Departments of Labor and Treasury in the coming days and weeks, and it is likely more relief legislation is on the way. As with all things involving the government, relief comes with strings and paperwork, but these provisions can offer some real assistance to those businesses that take the time to navigate their way through the process.

About the Author

Bradford Campbell, partner at Faegre Drinker Biddle & Reath LLP, advises financial service providers and plan sponsors on ERISA Title I issues, including fiduciary conduct and prohibited transactions. A nationally-recognized figure in employer-sponsored retirement plans, Brad is the former Assistant Secretary of Labor for Employee Benefits and head of the Employee Benefits Security Administration. As ERISA's former "top cop" and primary federal regulator, he provides his clients with insight and knowledge across a broad range of ERISA-plan related issues. He also serves as an expert witness in ERISA litigation. Brad has been listed as one of the 100 Most Influential Persons in Defined Contribution by 401kWire and has been listed as one of the top 15 ERISA attorneys in the country by a poll of the National Association of Plan Advisors. In addition, he testified before four Congressional Committees regarding the effects of the Department of Labor fiduciary regulation.

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