Chapter VI
Specialized Types of Retirement Income Plans
2019 Midwinter Report

American Bar Association
Section of Labor and Employment Law
Employee Benefits Committee
February 6-9, 2019
Nashville, Tennessee

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I. Employee Stock Ownership Plans

In May 2018, the DOL entered into a new settlement agreement, containing the same terms as the 2014 Greatbanc settlement agreement, with ESOP trustee Lubbock National Bank. This agreement, like others before it, arose out of allegations that the ESOP trustee caused the ESOP to purchase employer securities for more than fair market value. This agreement, which addresses the selection and oversight of an ESOP’s valuation advisor, requires Lubbock National Bank to follow certain procedures when serving as a trustee or other fiduciary to an employee stock ownership plan subject to Title I of ERISA, in connection with transactions involving the purchase or sale of non-publicly traded employer securities.

On August 13, 2018, the Main Street Employee Ownership Act (MSEOA) was enacted when the John S. McCain National Defense Authorization Act was signed into law. The new law encourages the creation of ESOPs and worker cooperatives by facilitating transactions via loans supported by the Small Business Administration (SBA). Previously SBA loans to help finance ESOPs were subject to requirements that made them impractical in most situations. The MSEOA eliminates those obstacles that were challenges under the old law and directs the SBA’s outreach infrastructure to encourage business owners to consider employee ownership. The most applicable SBA operated loan program for ESOPs is the 7(a) program. The law will not become fully effective until the SBA has developed regulations and guidelines under the MSEOA in 2019.

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2 Section 862 of H.R. 5515.
II. Section 401(k) Plans

B. Special Rules Applicable to 401(k) Plans

2. Contributions

   a. Elective Deferral Contributions

      ii. Limitations

      The elective deferral limit under Section 402(g)(1) for employees who participate in 401(k) plans is increased from $18,500 to $19,000 for 2019.

      The catch-up contribution limit for employees aged 50 or over who participate in 401(k) plans pursuant to Section 414(v)(2)(B)(i) remains unchanged at $6,000 for 2019.

      The limitation for defined contribution plans under Section 415(c)(1)(A) is increased from $55,000 to $56,000.

3. Distributions

   c. Hardship Distributions

   On November 14, 2018, the Internal Revenue Service released Proposed Regulations\(^3\) to implement and expand upon the changes to 401(k) hardship distribution rules, previously mandated by the Bipartisan Budget Act of 2018 (the “2018 Budget Act”). Together, the 2018 Budget Act and the Proposed Regulations relax 401(k) hardship distribution restrictions generally making it easier for participants to take distributions. The new rules permit plan sponsors to amend their plans for elective changes beginning as early as January 1, 2019.

   The Proposed Regulations mandate some changes by 2020. The 2018 Budget Act makes 3 important changes that relax restrictions on hardship distributions:

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\(^3\) 83 F.R. 56763 (11/14/18).
1. Hardship Distributions May Be Taken Prior to Taking a Loan. The requirement that a participant must take any available loan under the plan before taking a hardship distribution has been eliminated.

2. New Sources Eligible for Hardship Distributions. Additional contribution sources for a hardship distribution include: earnings on contributions; safe harbor matching or non-elective employer contributions; and QNECs and QMACs.

3. Elimination of Six-Month Contribution Suspension. The requirement that employee contributions be prohibited for at least six months following a hardship distribution is to be eliminated by amended regulations.

The Proposed Regulations clarify the 2018 Budget Act’s requirements, make other changes on availability of hardship distributions and provide start dates for permissive and mandatory changes:

1. Elimination of Six-Month Suspension is Permissive for 2019 but Mandatory for 2020.

2. Participant Certifications Will Be Required in Lieu of Contribution Suspension. Plans will be required to obtain a participant representation that there are insufficient cash or other liquid assets to meet a financial need beginning in 2020.

3. Elimination of Plan Loan Requirements is Permissive. The elimination of the requirement that a participant take all available plan loans before taking any hardship distribution is a permitted, not required, change. This change may be made as early as January 1, 2019.
4. Expansion of the Sources of Hardship Distributions is Permissive. Expanding the permitted sources of hardship distributions is a permissive change. 401(k) plans need not offer hardship distributions at all, and plans are free to limit the sources from which hardship distributions may be made. Expansion of the sources available for hardship distributions can be made as early as January 1, 2019.

5. List of Hardship Events is Expanding. Hardship related expenses include expenses for the repair of damage to the employee’s principal residence that would qualify for the casualty deduction under Section 165 of the Internal Revenue Code without regard to a federally declared disaster. In addition, a new category of hardship event has been added to include expenses incurred on account of a federally declared disaster where the principal residence or principal place of employment is located in a FEMA designated area. Also, designated beneficiaries are added to the list of those for whom medical, education and funeral expenses may be incurred to justify a hardship withdrawal. All of these changes are permitted to be effective as of January 1, 2018.

6. Plan Amendments Will Not Be Required Until a Later Date. Plan amendments may be done by the second calendar year that begins after the year in which the IRS Required Amendments List first includes these requirements.
III. Nondiscrimination Tests

B. Actual Deferral Percentage Test

On July 20, 2018, the IRS issued final regulations under sections 401(k) and 401(m) to permit amounts in a plan's forfeiture account to be used to fund Qualified Nonelective Contributions (QNECs) or Qualified Matching Contributions (QMACs) in order to pass the Actual Deferral Percentage (ADP) and Actual Contribution Percentage (ACP) tests. By revising the definition of a QNEC or QMAC to require that it be vested when allocated to participant accounts, rather than when first contributed to the plan, the final rule allows forfeitures to be used as QNECs and QMACs to help pass the ACP or ACP Tests. All other requirements for QNECs and QMACs continue to apply. The final regulations are effective July 20, 2018, and they apply to plan years beginning on or after July 20, 2018. However, plans may apply the regulations to earlier periods.

C. Actual Contribution Percentage Test

See Ch. 6. III. B., above regarding the IRS final rule issued on July 20, 2018.

D. Alternate Safe Harbors for ADP Testing

Final regulations amending the regulations under sections 401(k) and 401(m) were issued on July 20, 2018, which reverse the IRS's prior position that forfeitures could not be used to satisfy an employer's safe harbor contribution obligation.

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4 83 FR 34,469 (July 20 2018).
5 Id.
6 Id.
7 Id. The final regulations are also discussed at Ch. 6. III. B.
IV. Individual Retirement Arrangements

A. Section 403(b) Plans

1.c Coverage Rules

The universal availability rule allows for the exclusion of certain part-time employees who either are not expected to work 1,000 hours in their first year of employment, and/or did not work 1,000 hours in the year preceding the plan year. In 2018, the IRS clarified that part-time employees are subject to a “once in always in” rule: employees who are not subject to the part-time exclusion from universal availability, either because they are expected to work 1,000 hours or more in their first year or because they did work 1,000 or more hours in any year, must retain their eligibility to make elective deferrals to their employer’s 403(b) plan for the remaining duration of their employment.

IRS Notice 2018-95 offers relief to plan sponsors with respect to the exclusion of employees contrary to the “once in always in” rule in years preceding January 1, 2019, as well as “fresh start” relief allowing an employer to apply the part-time exclusion as if the “once in always in” rule were first effective as of January 1, 2018.

3.a Distributions

On November 14, 2018, the IRS issued proposed regulations to implement the mandate of section 41113 of the Bipartisan Budget Act of 2018 (P.L. 155-123, February 9, 2018) to eliminate the mandatory six-month cessation of elective contributions in the event of a hardship distribution, and to streamline the requirements for hardship distributions.

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8 IRS Notice 2018-95.
9 83 F.R. 56763.
B. Individual Retirement Arrangements, Simplified Employee Pension Plans, SIMPLE IRA Plans, and Deemed IRAs

2. Contributions to IRAs

a. Deductible Contributions to Traditional IRAs

The deductible amount under Code Sec. 219(b)(5)(A) for an individual making qualified retirement contributions was increased by $500 up to $6,000 for 2019.

The phase out levels for deductible contributions during the 2019 taxable year were also increased and are included in IRS Notice 2018-83.

4. Rollovers

In Notice 2018-74 (September 19, 2018), the IRS modified the two safe harbor explanations that may be used to satisfy the requirements under § 402(f) of the Internal Revenue Code that certain information be provided to recipients of eligible rollover distributions. The updated safe harbor explanations take into consideration certain legislative changes and recent guidance, including changes related to qualified plan loan offsets (as defined in § 13613 of the Tax Cuts and Jobs Act of 2017), guidance issued on self-certification of eligibility for a waiver of the deadline for completing a rollover (described in Rev. Proc. 2016-47), and include other minor clarifying changes.
V. Deferred Compensation Plans That Are Not Qualified Under Code Section 401

B. Section 457 Plans for State and Local Governments and Tax-Exempt Employers

3. Ineligible Section 457 Plans

Effective for tax years starting January 1, 2018, tax-exempt organizations must pay an excise tax equal to 20% of any excess remuneration paid to certain employees.\(^{10}\)

There are three key components to determining whether the excise tax applies in a given set of circumstances: whether the organization is one that is subject to the tax, whether the remuneration is sufficiently high to be subject to the tax, and whether the employee is a covered employee.

Organizations Subject to the Excise Tax

In order to be subject to this excise tax, the employer must be an organization exempt that:

- Is exempt from taxation under Code Section 501(a),
- Is a farmers’ cooperative organization described in Code Section 521(b)(1),
- Has income excluded from taxation under Code Section 115(1), or
- Is a political organization described in Code Section 527(e)(1).\(^{11}\)

Remuneration Subject to the Excise Tax

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\(^{10}\) Code Sec. 4960.

\(^{11}\) Code Sec. 4960(c)(1).
The excise tax is imposed on the employer, and the excise tax is calculated based on the amount of total remuneration in excess of $1 million plus any excess parachute payment.\textsuperscript{12} “Remuneration” means wages pursuant to Code Section 3401(a), but not including any designated Roth contributions.\textsuperscript{13}

The term “excess parachute payment” is compensation tied to an employee’s separation from service if the present value of that compensation is more than three times the employee’s current base salary.\textsuperscript{14}

The excise tax is imposed on all remuneration received by the employee from an organization or related organization. An organization is treated as a related organization if the related organization:

- Controls, or is controlled by, the organization,
- Is controlled by one or more persons that control the organization,
- Is a supported organization (as defined in section 509(f)(2)) during the taxable year with respect to the organization,
- Is a supporting organization described in section 509(a)(3) during the taxable year with respect to the organization, or
- In the case of an organization that is a voluntary employees' beneficiary association described in section 501(a)(9), establishes, maintains, or makes contributions to such voluntary employees' beneficiary association.\textsuperscript{15}

\textsuperscript{12} Code Sec. 4960(a).
\textsuperscript{13} Code Sec. 4960(c)(3).
\textsuperscript{14} Code Sec. 4960(a), (c)(5).
\textsuperscript{15} Code Sec. 4960(c)(4).
Covered Employees

For purposes of the excise tax, a covered employee:

- Is one of the 5 highest compensated employees of the organization for the taxable year, or
- Was a covered employee of the organization (or any predecessor) for any preceding taxable year beginning after December 31, 2016.\(^\text{16}\)

VI. Miscellaneous

A. Catch-Up Contributions

The annual limit on the amount of compensation that may be deferred under 401(k), 457(b), and 403(b) plans rose to $19,000 for 2019.\(^\text{17}\) The annual limit on age 50 catch-up deferrals for 401(k), governmental 457(b), and 403(b) plans remained at $6,000 for 2019.\(^\text{18}\)

B. Tax Credit for Qualified Retirement Savings Contributions

The credit rate depends on the AGI of the taxpayer. For 2019, those amounts are as follows:\(^\text{19}\)

\(^\text{16}\) Code Sec. 4960(c)(2).
\(^\text{17}\) IRS Notice 2018-83 (Nov. 19, 2018).
\(^\text{18}\) Id.
\(^\text{19}\) Id.
<table>
<thead>
<tr>
<th>AGI, married filing jointly</th>
<th>AGI, head of household</th>
<th>AGI, all other filers</th>
<th>Credit rate</th>
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<tr>
<td>$0 to $38,500;</td>
<td>$0 to $28,875</td>
<td>$0 to $19,250</td>
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<td>Over $32,000</td>
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