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2024 *VIRTUAL*

ERISA BASICS NATIONAL INSTITUTE

MINIMUM STANDARDS FOR TAX-QUALIFIED RETIREMENT PLANS

Monday, November 18, 2024 / 12:15 p.m. Eastern

The Panel

Name, Moderator
Organization
Insert Speaker Photo

Al Holifield
Holifield & Janich, PLLC

Benjamin Eisner
Cohen Weiss and Simon LLP

Donald J. Kieffer, Jr.
Internal Revenue Service

Background

- ERISA
  - Title I – Department of Labor
  - Title II – Department of Treasury/IRS
  - Title IV – Pension Benefit Guaranty Corporation
- Satisfaction of Internal Revenue Code ("IRC") for tax qualification
  - Voluntary
  - Many requirements duplicated in ERISA

Tax Advantages of Tax Qualified Plan

- Significant Financial Benefits
  - Employer
    - Tax Deduction
    - Tax Deferred Build up of Plan Assets
  - Employee
    - Tax Deferral for Contributions
    - Match/Employer Contributions
    - Tax-deferred build-up of plan assets

Consequences of Code Nonqualification

- Plan Disqualification
- Loss of Employer Deduction
- Plan Earnings are Taxed
- Vested Participants Taxed on Contributions and Value of Plan Benefit Before Paid

Topics To Be Covered

- Employer/Employee
- Types of plans
- Types of plan formulas
- Calculating service
- Participation and coverage
- Vesting
- Forfeitures
- Plan loans
- Defined benefit accrual rules
- Benefit limitations
- Timing of benefit payments
- Forms of benefit payments
- Taxation of benefits

Employer/Plan Sponsor

- Purpose of aggregation of related entities
- Controlled groups
- Affiliated service groups
- Plan Sponsor
  - Single employer plan = employer
  - Multiemployer = Board of Trustees
  - Multiple Employer = Lead Employer or Board of Trustees

Definition of Employee

- Common Law
- Self-Employed Individuals
- Leased Employees

Variety of Qualified Retirement Plans

- Single Employer Plan vs. Multiple Employer
- Multiemployer Plan
- Application of qualification rules vary based on type of plan or type of entity sponsoring plan

Defined Benefit (DB) Plan Structure

- Definite formula providing fixed benefit for life at normal retirement age
- Often formula based on salary, hours, work
- Enriched for early retirement or longer service (w/in limits)
- Contributions
  - Employer responsible (employee contributions rare)
  - Based on actuarial projections of funding needs
- Employer bears investment risk
- Provides benefits for surviving spouse unless waived
- Title IV of ERISA/PBGC Insurance

Defined Benefit Plan Types

- **Types of Defined Benefit ("DB") Plans.**
  - Final pay plans
  - Career average plans
  - Flat benefit/fixed/unit credit dollar plans
  - Cash balance plans and hybrid defined benefit
  - "Integrated" plans
  - Employee contributory plans – can be used with any of above.

Defined Contribution Plan Structure

- Contributions + investment earnings or losses = accrued benefit
- Plan specifies when contributions are made
- Benefits often payable before retirement
- Definitely determinable benefits – plan specifies how allocations will be done
- Employer contributions generally percentage of compensation

Defined Contribution Plan Types

- 401(k) Plan -- technically feature of plan (e.g., part of profit sharing plan)
- Profit Sharing Plan
- Stock Bonus Plans
- Money Purchase Pension Plan
- Employee Stock Ownership Plan
- 403(b) Plan
- DC plan must state whether it is intended to qualify under Code as money purchase pension plan, profit sharing plan or stock bonus plan.

Calculating Service

- Hours of Service
  - The Basic Definition
  - Plan Document
  - Equivalencies

Calculating Service

- Elapsed Time Alternative Rule
  - Periods of Service
  - Periods of Severance
- Changing from Hours Counting Method to Elapsed Time Method

Calculating Service

- Computation Periods
  - For Eligibility and Participation
  - For Vesting
  - For Benefit Accrual
  - Changing Computation Period

Breaks in Service

- Breaks in Service
- The Rule of Parity
- One-Year Hold Out Rule
- Family Leave
- Military Leave

Eligibility To Participate

MAXIMUM AGE AND SERVICE CONDITIONS ON TIME OF PARTICIPATION

- **Minimum Age and Service Basic Rule**.
  - No more than 1 year of service and no age limit above 21; or
  - Up to 2 years of service if 100% vested after 2 years
- **Initial Participation.**
  - Employee who meets eligibility rule must commence participation no later than earlier of:
    - 1st day of 1st plan year after meeting age and service rules; or
    - A date six months after satisfying age and service rules.
- **No Maximum Age Conditions.**

Exceptions to Eligibility

- **Permissible Business Criteria Exclusions**.
- **Caution** -- IRS Field Directive on part-time employees
- **One-Year Hold Out.**
  - General Rule: All years of service with employer taken into account for eligibility.
  - "Long-term, part-time employees" (workers with 500 hours in two consecutive years) must be allowed to defer in 401(k) plans.
  - Exception: "One year hold out" rule allows plan to disregard (temporarily) service credited *before* one-year break in service until year of service completed *after* return to employment.
  - Once employee completes year of service after reemployment, pre-break in service must be retroactively credited effective as of reemployment date.

Vesting

- Vesting Based on Service
  - Defined Benefit Plans
    - Five-Year Cliff
    - Three-to-Seven Year Graded

Vesting

- Vesting Based on Service
  - Defined Contribution Plans
    - Three-Year Cliff
    - Two-to-Six Year Graded

Vesting

- Vesting Based on Normal Retirement Age ("NRA")
  - § 411(a)(8) – later of age 65 or 5th anniversary
  - Substantiation if age 55-62
  - Multiemployer plan safe harbor
  - NRA below age 55 is noncompliant

Vesting

- Can’t amend plan to take away vested right
- Can’t extend vesting schedule for anyone with at least 3 years of service
- Full Vesting of Affected Participants Required
  - Plan termination
  - Complete discontinuance of contributions
  - Partial plan termination
- Faster Vesting
  - Top Heavy DB Plans
  - Hybrid Plans

Forfeitures

Benefits Cancelled But Not Treated as Forfeitures

- Death
- Reemployment
- Retroactive Amendment
- Withdrawals
- Cessation/Reduction of Contributions Under Multiemployer Plan
- Forfeiture of Matching Contribution

Plan Loans – Basics

Loans to participants if certain conditions met:

- Must not exceed lesser of (a) $50,000 minus highest outstanding unpaid loan balance in year before new loan, or (b) greater of ½ of vested benefit or $10,000. **Special Rules During COVID-19.**
- Repay within 5 years unless to buy participant's principal residence.
- Substantially level payments (not less frequently than quarterly) with exceptions.
- May permit cure period for missed payments.

Other Loan Considerations

- Special rules for participants who enter qualified military service.
- Legally enforceable written agreement with amount, term and repayment schedule.
- Available to all participants and beneficiaries on reasonably equivalent basis;
- Must bear reasonable rate of interest; and
- Be adequately secured.

Good Loans Gone Bad

- If loan fails to meet rules or defaults on payments = deemed distribution
  - Excise taxes if early distributions or to five percent owners.
- Deemed distribution not treated as in-service or rollover distribution.
- Plan loan offset occurs when account offset to repay loan.
- Offset = actual distribution. Can't offset if no in-service distribution.
- If a deemed distribution is not repaid, future loans can not be nontaxable unless repayments by payroll deduction and more collateral.
- Deemed distribution counts for determining amount of future loans.
- To avoid deemed distribution, prior defaulted loan must be repaid in same substantially level installments.
- No limit on number of loans under final regulations.
- **Special Rules During COVID-19.**

CODE LIMITS ON BENEFITS

IRS Notice 2023-75 - Defined Contribution Plans	2024	2023	Change
Maximum employee elective deferral (age 49 or younger)	$23,000	$22,500	+$500
Employee catch-up contribution (age 50 or older by year-end)	$7,500	$7,500	No change
Maximum employee elective deferral plus catch-up contribution (age 50 or older)	$30,500	$30,000	+$500
Defined contribution maximum limit, employee + employer (age 49 or younger)	$69,000	$66,000	+$3,000
Defined contribution maximum limit (age 50 or older), all sources + catch-up	$76,500	$73,500	+$3,000
Employee compensation limit for calculating contributions	$345,000	$330,000	+$15,000
Key employees' compensation threshold for top-heavy plan testing	$220,000	$215,000	+$5,000
Highly compensated employees' threshold for nondiscrimination testing	$155,000	$150,000	+$5,000

Minimums For Participation and Coverage

- **OVERVIEW**
  - Qualified plan cannot be limited to highly compensated employees
  - Plan must cover sufficiently broad group and proportionate number of lower-paid employees.
- Three general groups of rules:
  - *Minimum age and service and time of participation rules* to prevent unreasonable conditions ***before*** participation.
  - *Minimum coverage rules* to ensure sufficient % of lower paid employees ***eligible*** to participate.
  - *Minimum participation rules* to ensure employers cover sufficient # of employees.

Limits on Defined Benefit Plan Accrual Formulas

- Subject to accrual rules, benefits need not accrue uniformly. Formula may be "frontloaded," *i.e.*, richer for earlier years of career or "backloaded" so pension units higher for later years.
- **Statutory Constraints on Defined Benefit Accruals.**
- DB accrual formulas must meet 1 of 3 statutory tests:
  - "3% method"
  - "133-1/3% rule"
  - "Fractional rule"
- Accrual tests make allowances for accelerated benefit growth toward end of employee's career due to benefit and pay increases.

Limits on Defined Benefit Plan Accrual Formulas

Age discrimination.

- Accruals may not be reduced or discontinued on account of employee's age.
- May set outside limits on accruals based on length of service (e.g. a maximum of 30 years of service)
- May offset benefits paid to employee working past NRA for post-NRA benefit accruals.
- May suspend benefits at NRA if continue to work (rules vary by type of plan)
- PPA supports hybrid plans (e.g., cash balance plans) -- not age discriminatory if participant's account balance, determined as of any date under plan, at least as great as similarly situated, younger participant. (Conditioned on interest credits not greater than market rate of return.)

Maximum Annual Benefit Limits

Code §415 limits:

- annual pension that employer may provide to employee under all of qualified ***DB*** plans it sponsors
- amounts that may be allocated each year to employee's accounts under all of employer's ***DC*** plans.

- Maximum annual DB pension limit $275,000 in 2024 (indexed annually) for benefit payable annually as life annuity or QJSA at NRA.
- Benefit in another form adjusted to equivalent of straight life annuity.
- Maximum limit reduced for retirements before age 62 and increased for retirements after age 65.
- Options for plans to increase payments after retirement if restricted by Code §415 (but not retroactively).

Maximum Annual Benefit Limits

Maximum annual limits reduced for:

- Employees with less than 10 years of service (10% of limit per year).
- 100% of employee's average pay for highest-paid 3 consecutive years of plan participation. (Not applied to multiemployer plans.)
- High 3 Limit phased in at 10% per year over employee's years of service (not participation!) including before plan was adopted.
- "Pass" for annual pension of up to $10,000 for employees never covered by employer's DC plan (phased in over 10 years.)
- Definition of pay used in plan formula also limited.
    - Safe harbor definitions of pay and options
    - Code limit on includible pay ($345,000 for 2024)

Other Annual Benefit Rules/Limits

- **Definitely determinable benefits**.
  - Participant's benefits under DB plan must be "definitely determinable" at any given time.
  - Need fixed formula, even if all facts, such as final average pay or total service, may not be known at every point.
  - Limits employer discretion
- **Top-heavy requirements**. Ratio of value of accrued benefits for key employees (5% owners, 1% owners over $155,000 and 50 highest-paid officers over $220,000) vs. non-key can't exceed 60%.
- Minimum accrual for non-key employees if top heavy plan in year.
- **Other federal laws**.
  - Uniformed Services Employment and Reemployment Rights Act of 1994 ("USERRA")

TIMING OF DISTRIBUTIONS

Time of Payment From DC Plan

- Typically, termination of employment
- While employed (profit sharing, stock bonus)
  - Occurrence of specified event (e.g., disability)
  - After fixed number of years
  - After age 59 ½
  - COVID-19 distributions
- 401(k) plan – qualified reservist distributions
  - Hardship
- Plan termination (401(k) partial termination)

Time of Payment From DB Plan

- Attainment of normal retirement age or early retirement age
- Disability
- Death
- In-service distribution option after 12/31/19 age 59½ or older.

Required Minimum Distributions

- Distribution must begin by April 1 of calendar year following later of calendar year participant:
  - Reaches age 70 ½
  - Retires
- 25% excise tax on participant if required amount not distributed
  - Waived for reasonable error
  - Only 10% excise tax if failure is remedied within two years
- SECURE Act - Effective 12/31/19, required beginning date increased age from age 70½ to age 72 for participants who reach age 70½ after 12/31/19
- SECURE 2.0 Act – Effective 12/31/22, required beginning date increased age from age 72 to 73 for participants who reach age 72 after 12/31/22.
- COVID-19 exceptions

Timing of Distributions After Death

- Distributions after death continue as selected by participant, can't slow payment stream
- If distributions have not begun at death, paid to beneficiary
  - Within 5 years
  - Begin within 1 year and paid over beneficiary's life
- Spouse may defer until participant's RMD

BENEFIT PAYMENT FORMS

Standard DB Payment Options

- Single life annuity-required "QJSA" for unmarried participants
- Joint and survivor annuity-qualified and optional
- Term certain annuities (e.g., 120 months)
- Lump sums – perhaps limited to small benefits ($7,000 or less)

Standard DC Payment Options

- Lump sum
- Installments for 10, 15, or 20 years
- Money purchase pension plans must satisfy QJSA/QPSA/QOSA rules
- Other DC plans not affected if –
  - No annuities
  - Surviving spouse is sole beneficiary or consents to another beneficiary

Taxation of Distributions

A. Penalties on Early Distributions (COVID-19 exceptions)
B. Special Treatment for Lump-Sum Distributions
C. Basis Recovery Rules
    1. General
    2. Defined Benefit Plan
    3. Defined Contribution Plan
D. Net Unrealized Appreciation
E. Rollovers
F. Direct Rollovers

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