November 21, 2013

Tax-Qualified Retirement Plans: Amendments and Other Year-End Action Items

Plan sponsors should consider whether they need to make certain plan amendments or provide certain plan notices prior to the end of the year.

The end of the year marks the deadline by which sponsors of qualified retirement plans may need to take various steps to preserve their plans' tax-qualified status. This LawFlash describes two types of action items in particular—plan amendments and participant notices—that sponsors must adopt or provide by the end of 2013 (or relatively soon thereafter). The list is not exhaustive but is intended to serve as a reminder of items that plan sponsors should review and consider before the end of the year. The discussion below assumes that a plan has a calendar-year plan year.

Plan Amendments

Required Amendments

Funding-based Limits on Benefit Payments and Accruals. For sponsors of single- and multiple-employer defined benefit plans, the deadline to adopt an amendment relating to funding-based limits on benefit payments and accruals under Internal Revenue Code (IRC) sections 401(a)(29) and 436 is the latest of (1) the last day of the first plan year that begins on or after January 1, 2013; (2) the last day of the plan year for which IRC section 436 is first effective for the plan; or (3) the due date (including extensions) of the employer's tax return for the plan year that contains the first day for which IRC section 436 is first effective for the plan. For calendar-year plans, this means the plans must be amended by December 31, 2013.

The Internal Revenue Service (IRS) issued a sample IRC section 436 amendment in its Notice 2011-96 that sponsors can adopt for this purpose. Although sponsors are not required to adopt the sample amendment, they may find it helpful to do so (as appropriately tailored to fit their plans' terms). IRS agents who review a plan's determination letter filing typically find little fault with IRS sample amendments and are unlikely to request changes or additions.

Hurricane Sandy Relief Amendments. Plan sponsors whose participants were adversely affected by Hurricane Sandy were allowed to provide loans and/or hardship withdrawals through February 1, 2013, even if their plan documents did not otherwise allow such loans or withdrawals. In addition, if their plan documents already provided for loans or hardship withdrawals, sponsors were allowed to be more flexible in applying their plans' terms. For example, sponsors were permitted to allow hardship withdrawals for necessities such as food and shelter, even if their plans had more restrictive definitions of "hardship." Similarly, sponsors did not have to enforce the usual six-month suspension on 401(k) contributions if a participant withdrew a Sandy-related hardship distribution.

With a plan that does not currently provide for loans or hardship withdrawals, the plan document must be amended by the end of the first plan year beginning after December 31, 2012 to add (as applicable) a provision allowing loans or hardship withdrawals if Sandy-related loans or hardship distributions were granted. On the other hand, if a plan document already allowed loans or hardship withdrawals prior to Sandy, the IRS has noted that the document need not be amended to reflect the permitted operational flexibility; for example, a document already

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allowing for hardship distributions (prior to Sandy) under the IRS's safe-harbor "laundry list" of events would not need to be amended to include Sandy-related food or shelter needs as a bona fide hardship. A sponsor can (if desired) amend its plan to reflect Sandy-related administrative decisions, even if an amendment is not strictly required.

Automatic Revocation of Beneficiary Designations Upon Legal Separation. In its September 13, 2013 "Employee Plan News," the IRS discussed a plan-drafting issue that may trigger qualification errors. Specifically, participants who divorce sometimes overlook designating a new beneficiary to replace their former spouses. To avoid this unintended result, some plans contain provisions that automatically revoke a participant's spousal beneficiary designation upon divorce. Other plans go further and also apply automatic revocation with a legal separation. This is problematic since the IRS allows automatic revocation of spousal preretirement death benefits only for unmarried (i.e., divorced) participants, and a legally separated participant is still married under state domestic relations law. IRS regulations do, however, allow legally separated participants to *affirmatively* waive spousal death benefits and name another beneficiary without spousal consent. As a result, an automatic revocation provision—if applied to a legally separated participant (as distinct from a divorced one)—may result in the payment of preretirement death benefits to the wrong person.

The IRS has not indicated such automatic revocation language is, in and of itself, a qualification defect. Therefore, if a plan is preapproved (i.e., a prototype or volume submitter plan), the company that drafted and issued the document will provide an amendment if it determines one is needed; employers should avoid unilaterally amending such a plan themselves since doing so could undercut reliance on the plan as an IRS preapproved document. Individually designed plans, in contrast, can be amended by the plan sponsors. In both cases, however, plan sponsors should refrain from operationally using automatic revocation of spousal preretirement death benefits for legally separated participants.

Upcoming Amendments. The IRS has indicated it will issue guidance regarding the effect on qualified retirement plans of the U.S. Supreme Court's holding on same-sex marriage (*United States v. Windsor*), including the date by which related plan amendments must be adopted and their possible retroactive application. In the meantime, sponsors must operate their plans in accordance with the Court's decision, related IRS guidance (including Revenue Ruling 2013-17), and Department of Labor (DOL) Technical Release 2013-04.[1]

The IRS is also expected to issue final regulations on interest rates and market rates of return for cash-balance and other hybrid plans. That guidance will clarify the timing of related amendments.

Discretionary Amendments

A plan amendment for discretionary changes (i.e., changes not required by law, such as plan design changes) must be adopted by the end of the plan year in which the amendment is effective. Thus, calendar-year plans must be amended by December 31, 2013 for optional changes that took effect in 2013. Remember that this rule is subject to the restrictions of IRC section 411(d)(6), which generally prohibits the retroactive reduction of benefits. Amendments intended to reduce benefits need to be adopted prospectively and may not be able to be postponed until the year-end deadline.

Determination Letter Applications for Cycle C Plan Sponsors

Under the IRS determination letter program, individually designed plans have staggered five-year remedial amendment cycles. The last remedial amendment cycle for individually designed plans (Cycle B) ended on January 31, 2013, and the current five-year remedial amendment cycle (Cycle C) for individually designed plans began on February 1, 2013.

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1. For more information regarding these requirements, please see our September 3, 2013 LawFlash, "Same-Sex Marriages Recognized for Federal Tax Purposes," available at http://www.morganlewis.com/pubs/EB_LF_Same-SexMarriagesRecognizedTaxPurposes_03sep13, and our September 17, 2013 LawFlash, "Guidance on Tax Treatment of Same-Sex Marriages Takes Effect," available at http://www.morganlewis.com/pubs/EB_LF_StepsForComplyingWithSame-SexMarriageGuidance_17sep13.

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Cycle C applies to employers with employer tax identification numbers that end in 3 or 8 and to most governmental plans. Plan sponsors that must file in Cycle C must submit their plans to the IRS by January 31, 2014.

The IRS released the 2012 Cumulative List, which describes all of the required provisions that must be included in each plan submitted for a determination letter during the Cycle C submission period. Plan sponsors should review the 2012 Cumulative List prior to submitting a plan for a determination letter to ensure that any additional amendments outlined on the 2012 Cumulative List are included in the plan document.

New Plan Limitations for 2014

On October 31, 2013, the IRS announced increases for many of the qualified retirement plan dollar limits. Many of the new dollar limitations will change for 2014 because the increase in the cost-of-living index met the statutory thresholds that trigger their adjustment. However, some dollar limits will remain unchanged. The chart below highlights some of the qualified retirement plan dollar limits for 2014 and the last two years.

IRC Section Limit	2014	2013	2012
Elective deferral (contribution) limit under IRC section 402(g)	$17,500	$17,500	$17,000
Catch-up contribution limit under IRC section 414(v)(2)(B)(i)	$5,500	$5,500	$5,500
Annual compensation limit under IRC section 401(a)(17)	$260,000	$255,000	$250,000
Maximum defined benefit annuity limit under IRC section 415(b)(1)(A)	$210,000	$205,000	$200,000
Maximum defined contribution annual additions limit under IRC section 415(c)(1)(A)	$52,000	$51,000	$50,000
Highly compensated employee threshold under IRC section 414(q)(1)(B)	$115,000	$115,000	$115,000
Key employee threshold under IRC section 416(i)(1)(A)(i)	$170,000	$165,000	$165,000

Annual Notice Requirements

Depending on the type of qualified plan and the plan's features, one or more annual notices may be required. Please carefully review the below notices to determine whether any must be issued for your plan.

Notice	Explanation
Annual Safe-Harbor 401(k) Plan Notices	*Traditional Safe-Harbor Plan Notice.* Safe-harbor 401(k) plans must provide annual safe-harbor notices to all plan participants describing the safe-harbor contribution and other material plan features. *"Wait and See" Safe-Harbor Notice.* Sponsors of safe-harbor 401(k) plans that intend to satisfy the safe-harbor requirements through a 3% nonelective contribution may wish to follow the "wait and see" approach. Plan sponsors that follow this approach must provide a notice prior to the beginning of the plan year notifying eligible employees that the safe harbor may be adopted. Additionally, plan sponsors that previously provided a "wait and see" notice prior to

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Notice	Explanation
	the beginning of the ongoing plan year and that decide to implement a safe-harbor arrangement prior to the end of the plan year (by making the 3% nonelective contribution) must provide supplemental notices to eligible employees informing them that the safe-harbor arrangement will be adopted. The traditional safe-harbor notice and the contingent notice must be provided at least 30 days and no more than 90 days prior to the beginning of the plan year. The supplemental notice must be provided at least 30 days before the last day of the plan year. Thus, calendar-year plans will need to provide the applicable notice by December 1, 2013. *Note: If you previously provided a "wait and see" safe-harbor notice and have decided to implement the 3% nonelective safe-harbor contribution for this plan year, in addition to providing the notice described above, you will also need to amend your plan to provide for the safe-harbor contribution prior to the end of the plan year.* *Also note that the IRS issued new regulations on November 15, 2013 that allow plans using the 3% nonelective contribution approach (i.e., plans that are already drafted to use the 3% nonelective safe-harbor approach as of the first day of the plan year) to reduce or suspend contributions after the start of the plan year if the above-described traditional safe-harbor plan notice alerted eligible employees to that possibility. Employers that notify employees of this possibility may make the reduction or suspension for any reason at all; they are not required to demonstrate a business hardship or other compelling reason. Specifically, the traditional notice must inform eligible employees that the safe harbor may be reduced or suspended during the plan year and that the reduction will not apply until at least 30 days after all eligible employees are provided a supplemental notice of the reduction or suspension. Employers that sponsor a safe-harbor plan using the 3% nonelective contribution approach may want to consider adding, as a routine matter, language to their traditional safe-harbor notices alerting eligible employees to the possibility of a mid-year reduction or suspension.*
Qualified Default Investment Alternative Notices	Participant-directed defined contribution plans that invest participant contributions for which no affirmative investment election has been made into a qualified default investment alternative (QDIA) must provide an annual notice. The notice must be distributed to all participants who have been or may be defaulted into a QDIA. The notice must be provided at least 30 days before the beginning of each plan year. For calendar-year plans, notice must be provided by December 1, 2013. A QDIA is an investment alternative (for example, a balanced fund or target-date fund) in a participant-directed 401(k) or profit-sharing plan into which participant contributions are "defaulted" if the participant has not made an affirmative investment election. If a plan fiduciary properly selects a QDIA and follows the specific QDIA requirements, which include providing an initial and an annual notice, the plan fiduciary will generally receive fiduciary protection for those defaulted investments under section 404(c) of the Employee Retirement Income Security Act of 1974, as amended (ERISA), because participants will be "deemed" to have elected to invest their contributions into the QDIA. *Note: One of the many QDIA notice requirements is that the notice be "separate" from any other notices that are provided. However, the QDIA notice is permitted (but not required) to be combined with the safe-harbor notice (described above) and the automatic enrollment notices (described below).*
Annual Automatic Enrollment and Escalation	Sponsors of 401(k) plans that automatically enroll participants must provide an annual notice to all eligible employees describing the circumstances under which contributions may be automatically contributed to the plan. This notice may be combined with the QDIA notice described above. This notice must be distributed at least 30 days, but no more than 90 days, prior to the beginning of each plan year. For calendar-year plans, the notice must be provided

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Notice	Explanation
Notice	by December 1, 2013. *Note: There are a number of different automatic enrollment arrangements (for example, one arrangement simply provides for the automatic enrollment of participants, while another is linked to satisfying 401(k) plan discrimination tests), but each requires a notice.*

Puerto Rico Retirement Plans

In May 2013, the Puerto Rico Treasury Department (Hacienda) issued Circular Letter No. 13-02, which provided an extension for employers sponsoring Puerto Rico qualified retirement plans both to adopt required amendments under the Puerto Rico Tax Code of 2011 and to file for a related favorable determination letter from Hacienda.

Plan sponsors must amend their Puerto Rico qualified plans and submit them to Hacienda on or before the due date of an employer's Puerto Rico income tax return for 2013, *excluding* any extension. The normal tax-filing deadline is the 15th day of the fourth month after the end of the sponsor's taxable year. Therefore, for a calendar-year taxpayer, the due date without extension is April 15, 2014, while the due date for a taxpayer with a fiscal year ending July 31, 2014 would be November 17, 2014.

Plan sponsors can both amend and submit their plans three months later than this due date if they pay a $150 fee to Hacienda and include with their determination letter request either a copy of Form SC 2644 (Request for Extension of Time to File the Income Tax Return) or a certification issued by an employee, officer, or director of the employer attesting to the prior filing of a Form SC 2644. This means that a calendar-year taxpayer could amend and file as late as July 15, 2014, while the July 31 fiscal year taxpayer could amend and file as late as February 16, 2015.

Note: Plan sponsors are urged to consult with Puerto Rico counsel for compliance with the 2011 PR Code and Hacienda determination letter filing procedures.

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