ERISA Roundup

A quarterly recap of recent publications from BDO's ERISA Center of Excellence

Q4 2023

BDO

A Note from BDO's National ERISA Practice Leaders

Now that we are in the the new year, it's a great time to reflect on our accomplishments from the prior year and prepare for a successful new year.

As we continue to plan out our goals in 2024, plan sponsors are thinking about how to offer benefits that resonate with a multi-generational workforce and remain competitive in an evolving marketplace —while staying within the organization's budget. Through BDO's ERISA Center of Excellence and this publication, we discuss trends impacting the industry and regulations to keep top of mind.

If your goals include staying current on ERISA topics, we invite you to follow along with our regular insights at www.bdo.com/erisa and our podcast series BDO Talks ERISA. Feedback on our content is always welcomed — you can reach us at BDOTalksERISA@BDO.com.

MARY ESPINOSA
Assurance Principal

ERIN BREIT
Assurance Principal
Employee Benefit Plans

LUANNE MACNICOL
Assurance Principal

JESSICA FRIEDLY
Assurance Principal
Employee Benefit Plans

JODY HILLENBRAND
Assurance National
Technical Principal

BDO's ERISA Center of Excellence is your source for insights on emerging regulations, industry trends, current topics, and more. Visit us at www.bdo.com/erisa or follow along on Twitter: @BDO_USA and #BDOERISA.

In this Issue

2024 Deadlines and Important Dates 4

Stay Up to Date with Our Podcast, *BDO Talks ERISA* 5

2024 Cost-of-Living Adjustments for Qualified Retirement Plans 6

Retirement Plans & Cybersecurity: Insights for Plan Sponsors 7

HSA Contribution Limits Set to Increase in 2024 10

Emergency Savings Options: A Bridge to Achieve Employee Savings Goals 12

New Requirement to Cover Long-Term Part-Time Employees in 401(k) Plans Enters Into Effect 14

2024 Deadlines and Important Dates

Sponsors of defined benefit and defined contribution retirement plans should keep the following deadlines and other important dates in mind as they work toward ensuring compliance for their plans in 2024. Dates assume a calendar year plan. Some deadlines may not apply, or dates may shift based on the plan sponsor's fiscal year. For additional support, please contact your BDO representative.

JANUARY

- **15 / Fund:** Possible fourth quarter 2023 contribution due for defined benefit pension plans.
- **31 / Action:** File IRS Form 945, Annual Return of Withheld Federal Income Tax, by January 31 for non-payroll income taxes, such as taxes withheld by retirement plans, during 2023.
- **31 / Action:** Distribute IRS Form 1099-R to participants by January 31 for 2023 retirement plan distributions.

FEBRUARY

- **28 / Action:** File IRS Form 1096, Annual Summary and Transmittal of US Information Returns, with IRS if using paper transmittal by February 28 for 2023 tax year.
- **28** / Action: File IRS Form 1099-R in paper format with the IRS by February 28 for 2023 retirement plan distributions.

MARCH

- **15 / Action:** Highly compensated employees who fail ADP/ ACP test for prior plan year must have refunds processed by March 15 (other than eligible automatic contribution arrangements).
- **15 / Fund:** Partnerships and S Corporations that are not getting an extension must fund employer contributions to receive tax deduction for the prior year.

APRIL

- **1 / Action:** 401(k) plans with publicly traded employer stock that follow Article 6A of the Regulation S-X (SEC format) must file Form 11-K with the Securities and Exchange Commission by April 1. **Note:** The IRS "weekend rule" does not roll the April 1 deadline to the next business day if April 1 falls on the weekend or holiday.
- **1 / Action:** Recordkeeper (or other responsible party) completes and files Form 1099-R electronically with the IRS by April 1 for 2023 retirement plan distributions.
- **1 / Action:** April 1 deadline for 5% business owners and terminated participants who turned 73 in 2023 to receive their required minimum distribution (RMD). **Note:** the IRS "weekend rule" does not roll the April 1 deadline to the next business day if April 1 falls on the weekend or holiday.
- **15 / Fund:** April 15 possible first quarter 2024 contribution due for defined benefit pension plans (i.e., contribute by April 15 before the weekend, as contribution deadlines are not extended to the next business day).
- **15 / Distribute:** Participants who contributed over 402(g) or 415 limits in the previous year must be refunded the excess amount by April 15.
- **15 / Action:** File PBGC Form 4010, Notice of Underfunding for single-employer defined benefit plans with more than $15 million aggregate underfunding by Monday, April 15.
- **15 / Fund:** C-Corporations and Sole Proprietors that are not getting an extension must fund employer contributions by April 15 to receive tax deduction for the prior year.
- **15 / Fund:** IRA contributions for the prior tax year must be funded by April 15.
- **29 / Action:** Send annual funding notice to participants of single and multi-employer defined benefit plans over 100 participants by April 29.

Stay Up to Date with Our Podcast, *BDO Talks ERISA*

BDO TALKS ERISA

Our ERISA Center of Excellence releases a monthly podcast — *BDO Talks ERISA!* This series covers best practices around all things ERISA and any other HR-related topics, including:

- How to avoid common compliance issues
- How to navigate the ins-and-outs of ERISA's fiduciary provisions
- Our own experiences working for BDO's ERISA Services group
- A deeper dive into the insights we share through our BDO ERISA Center of Excellence

Listen to new episodes of *BDO Talks ERISA* **here** or subscribe on **Apple Podcast** or **Spotify**. If you have suggestions for future topics or have a question for us to answer, please **send us an email**.

RECENT EPISODE

Episode 33: Navigating Financial Wellness

In this episode, our BDO co-hosts are joined by Jim Sinnott, CFP, to discuss what the financial wellness program includes for participants.

2024 Cost-of-Living Adjustments for Qualified Retirement Plans

BDO presents a highlights summary of the significant cost-of-living adjustments (COLA) effective for 2024. These adjustments recently announced by the Internal Revenue Service (IRS) and the Social Security Administration (SSA) have a wide-ranging impact, including the savings rate for retirement plans. In general, annual compensation amounts and limits for elective deferrals were increased, while catch-up contribution limits remain unchanged. BDO will continue to provide updates on regulatory matters impacting retirement plans in the coming year — to sign up for BDO newsletters and other insights, visit the **ERISA Center of Excellence**.

CODE SECTION	2024	2023	2022
401(a)(17) /404(l) Annual Compensation	$345,000	$330,000	$305,000
402(g)(1) Elective Deferrals	$23,000	$22,500	$20,500
408(k)(2)(C) SEP Minimum Compensation	$750	$750	$650
408(k)(3)(C) SEP Maximum Compensation	$345,000	$330,000	$305,000
408(p)(2)(E) SIMPLE Maximum Contributions	$16,000	$15,500	$14,000
409(o)(1)(C)(ii) ESOP Limits	$1,380,000	$1,330,000	$123,000
	$275,000	$265,000	$245,000
414(q)(1)(B) HCE Threshold	$155,000	$150,000	$135,000
414(v)(2)(B)(i) Catch-up Contributions	$7,500	$7,500	$6,500
414(v)(2)(B)(ii) Catch-up Contributions	$3,500	$3,500	$3,000
415(b)(1)(A) DB Limits	$275,000	$265,000	$245,000
415(c)(1)(A) DC Limits	$69,000	$66,000	$61,000
416(i)(1)(A)(i) Key Employee	$220,000	$215,000	$200,000
457(e)(15) Deferral Limits	$23,000	$22,500	$20,500
1.61-21(f)(5)(i) Control Employee	$135,000	$130,000	$120,000
1.61-21(f)(5)(iii) Control Employee	$275,000	$265,000	$245,000
Taxable Wage Base for Social Security	$168,600	$160,200	$147,000

BDO works collaboratively with clients to test retirement plan limits while performing an audit of the qualified retirement plan. For more information about our ERISA audit services, plan administration and actuarial services, visit **BDO's Employee Benefit Plan Audits**.

Retirement Plans & Cybersecurity: Insights for Plan Sponsors

Cybersecurity is a top concern for many U.S. businesses and industries. The retirement plan industry holds over $37 trillion in total participant retirement accounts, yet only 27 percent of plan sponsors have a written cybersecurity policy, according to the 65th annual Survey of Profit Sharing and 401(k) Plans by the Plan Sponsor Council of America (PSCA). Government regulation has driven cybersecurity enhancements in other industries (such as enhanced safeguards for credit cards and online accounts in the banking industry). While the retirement industry currently lacks a comprehensive system of cybersecurity laws and regulations, the Department of Labor (DOL) has turned its attention to cybersecurity for employee benefit plans.

DEPARTMENT OF LABOR (DOL) CYBERSECURITY TWO-PRONGED FOCUS

In April 2021, the DOL issued cybersecurity guidance or tips for plan sponsors when hiring a service provider, best protection practices, and online security information for participants and beneficiaries. None of this guidance is required by law, but the DOL is using these tools as a basis to ask for more cybersecurity-related information when it conducts audits plans. Since issuing the guidelines, the DOL has increasingly expressed interest in gathering information about audited plans' documents for policies, procedures, and guidelines related to cybersecurity. It has also begun requesting specific details from plan sponsors as to how their plan service providers use participant data. According to the PSCA study, 56 percent of plans have a participant data use policy as part of the recordkeeper service agreement. If a plan is audited by the DOL, the plan sponsor should be prepared to answer questions about such policies and provide follow-up information if requested.

ERISA ADVISORY COUNCIL'S REPORT ON CYBERSECURITY INSURANCE

The DOL ERISA Advisory Council (the Council) consists of 15 appointees representing interests of employer organizations, employers, specific industry fields, and the general public. The Council's December 2022 report analyzed how cybersecurity insurance addresses risk in employee benefit plans. The council heard from a number of industry experts representing a wide cross-section of interests – central themes of the testimonies shared were that the issue is complex, not widely understood, and requires further study. For instance, one witness suggested the Council consider whether the Employee Retirement Income Security Act of 1974 (ERISA) requires plan fiduciaries and service providers to guarantee a loss when they took reasonable steps to prevent fraud.

WHAT CAN PLAN SPONSORS DO TO MITIGATE CYBER RISKS

With the increased regulatory focus and greater awareness of cyber vulnerabilities within the retirement plan industry, plan sponsors are looking for ways to meet their fiduciary responsibility in mitigating retirement plan cybersecurity risks. The following are just a few of the currently available ways in which sponsors can address the risks:

Cybersecurity Insurance

For sponsors considering retirement plan cybersecurity insurance, a key question when evaluating potential policies is asking which party would be liable for a cybersecurity breach. Additional considerations include identifying who is the insured party (the sponsor, the plan or both?), who is responsible for purchasing the policy (the sponsor or the plan?), and the full scope of the policy (in other words, what is or is not covered in the event of a cyber breach?).

Another aspect to think about is how much coverage is needed for the policy. According to this year's **IBM Cost of Data Breach Report** the average cost of a breach in the United States was $9.48 million. The sponsor should also consider factors unique to its company and the plan, etc.

Cybersecurity Risk Management Program

Through the DOL's audit investigations, some sponsors are feeling increased pressure to implement a cybersecurity risk management program that has policies and procedures directly addressing the employee benefit plan.

If a sponsor decides to adopt a risk management program, ensuring the policy is the right fit is crucial. A boiler-plate policy is generally not a good approach since it may not fully align with the company's processes and procedures. Any program put in place around the plan's cybersecurity should be clearly understood, routinely followed and updated regularly. A program that is put into place, but not followed or updated could become substantiating evidence in the event of plan litigation following a cyber breach.

Add IT to the Plan Committee

With the ever-evolving cyber technology, adding an IT professional to the plan administrative committee (those charged with plan governance) informs the committee about emerging trends and advancements in cybersecurity. The IT professional can also help educate on the latest cyber tools and best practices, as well as help in the evaluation process to understand the technological aspects of the plan, such as software systems, data security, and infrastructure requirement. This professional can also encourage the committee to provide appropriate time and resources for plan cybersecurity.

Overall, inclusion of an IT proficient employee on the committee charged with oversight and administration of the plan can help ensure the technology-related aspects of the retirement plan are well-managed, secure, and aligned with the company's goals.

Cybersecurity Is a Shared Responsibility

The cyber community has fully embraced that it is no longer a question of who is responsible in the event of a cyber breach, but rather that all parties share in the responsibility for cybersecurity. The plan sponsor can play a key role in educating plan participants about their role in building a stronger cybersecurity defense. This education would include emerging trends in cyberhacking and proper risk-mitigation practices, such as two-factor authentication, regular account monitoring and avoidance of phishing attacks. The PSCA study reported 61 percent of plans have cybersecurity awareness campaigns and half have issued email alerts on specific cyber issues.

BDO Insight: Pay Attention to the Plan's Cybersecurity Process

When determining a comprehensive approach to cybersecurity and assessing the plan's cyber risk profile, plan sponsors should remember that ERISA's standard of care stipulates fiduciaries must act in the best interests of participants and beneficiaries. Cybersecurity risks are an ongoing part of current-day plan administration — as such, plan fiduciaries have a responsibility to ask questions and take procedural steps to lessen cybersecurity risk is as much as reasonably possible.

Knowing what the plan's service providers are doing to prevent cybersecurity attacks, educating participants, and documenting policies and controls are all sound actions to protect both the plan and the sponsor in the event of a cyber-breach.

For larger plan sponsors or those who have experienced a breach, System and Organization Controls (SOC) for cybersecurity reports can provide an independent assessment of the sponsor's implemented cybersecurity controls. Having these reports allows plan sponsors to better manage their risk, support compliance, promote transparency, and make informed decisions about plan vendor selection and monitoring.

Each plan sponsor is tasked with evaluating their plan's unique cybersecurity risks and needs. Your BDO representative can help you assess your plan's current cyber risk profile.

HSA Contribution Limits Set to Increase in 2024

OVERVIEW

The IRS annually evaluates limits and thresholds for various benefits and provides increases, as needed, to keep pace with inflation. The health savings account (HSA) contribution limits effective January 1, 2024, are among the largest HSA increases in recent years.

After the inflation adjustments, the 2024 HSA limits and thresholds are as follows:

2024 LIMITS & THRESHOLDS

	Single Coverage	Family Coverage
Annual HSA Contribution	$4,150	$8,300
Annual HSA Contribution for participants aged 55 and older	$5,150	$9,300
Maximum employer contributions for excepted benefits	$2,100	$2,100
Minimum deductible for high-deductible plan	$1.600	$3,200
Maximum out-of-pocket for high-deductible plan	$8,050	$16,100

PLANNING FOR THE TRANSITION

Although the changes are not effective until the beginning of 2024, sponsors are encouraged to plan for the transition by discussing implementation changes needed with plan service providers to ensure the new limits are incorporated next year. Additionally, sponsors can also communicate these increases to plan participants to provide them with additional planning opportunities, as increased contributions may be carried over into future years, as discussed further below.

Earlier this summer, BDO's ERISA Center of Excellence published a two-part series on HSAs that discussed key provisions, the potential for using HSAs as retirement savings vehicles, and tips to consider when selecting an HSA provider. Below we provide key highlights from the articles as well as the article links.

Despite Growth, HSAs Largely Untapped for Retirement Savings

HSAs have the potential to continue to grow as retirement "piggy banks" that can be:

- Spent tax-free at any time on qualifying medical expenses,
- Retained if not spent during the current year,
- Treated as an additional savings fund with nonmedical distributions before participant reaches age 65 subject to income taxes and an additional 20% penalty, and
- Treated as an additional retirement fund with nonmedical distributions after age 65 subject only to income taxes like individual retirement accounts (IRAs).

Clearing up some common misconceptions about HSAs:

- While their acronyms may sound similar to HSA, health reimbursement accounts (HRAs) and flexible spending accounts (FSAs) differ. Both the employee's and employer's contributions to HSAs belong to the employee, even after the termination of employment:
  - HRAs are owned and funded by employers and must be left behind when the employee leaves the employer.
  - FSAs have a "use it or lose it rule" that generally requires contributions to be used within the year the contribution is made, thereby preventing the FSA from accumulating a balance to serve as long-term savings or retirement funds.
  - HSAs require a high-deductible health plan (HDHP) and offer tax advantages for medical expenses.

Tips for Effective HSA Plan Provider Selection

Plan sponsors can use the Employee Benefit Security Administration's Tip Sheet for Selecting and Monitoring Service Providers:

- Consider the services needed to operate the HSA,
- Review whether the HSA vendor can provide bundled benefit offerings,
- Understand the terms of the contract and have a written record of the hiring process, and
- Regularly evaluate the HSA vendor.

Plan sponsors should also be aware of the key trends:

- Use a consultant or benefits broker to develop the HSA program,
- Important features reported by plan sponsors include having a debit card, 24/7 customer service, and employee engagement/communication, and
- Consider offering investment options based on participants' needs.

To avoid subjecting the HSA to ERISA compliance requirements, plan sponsors should:

- Understand the Department of Labor conditions HSA sponsors must follow to stay outside the realm of ERISA law and
- Avoid requiring employee contributions, limiting fund movements, and making investment decisions (among other things).

Our Perspective

Sponsors can work with their plan administrators to develop participant communications that highlight the long-term benefits of HSAs (even for healthy employees) and explain how the increased HSA limits for 2024 can boost individual tax-advantaged savings.

Plan participants may not be aware or fully understand the potential benefits offered by HSA contributions:

- Employer contributions to the HSA are not taxed to the employee when paid to the account,
- Employee contributions to the HSA are tax-deductible,
- Invested account balances grow tax-free,
- Funds are not beyond the reach of the employee, but withdrawals might be subject to income taxes and penalties if not used for health expenses:
  - Tax-free if used for eligible healthcare purposes,
  - Taxable at ordinary income tax rates if used for non-health expenses, and
  - Additional 20% penalty owed on non-health distributions made before age 65, and
- Funds are portable, meaning they are not forfeited when the employee changes employers, which allows the individual to have access to the funds as their healthcare needs increase as they age.

A better understanding of HSA provision and the increased limits may spark a participant's interest in the accounts and provide employers with another vehicle to improve employee satisfaction. Sponsors can work with their plan administrators to develop communication that highlights the long-term benefits of HSAs, even for healthy employees.

Please contact a BDO professional to discuss the unique features of HSAs and determine whether they might be an option for your company.

Emergency Savings Options: A Bridge to Achieve Employee Savings Goals

American workers are facing a savings crisis made more acute by soaring interest rates, persistent inflation, and other economic stressors. In its 2023 Workplace Wellness Survey, the Employee Benefit Research Institute (EBRI) found that 30% of workers could not pay for an unexpected $500 expense, while half of EBRI's respondents considered their retirement savings to be their only "significant emergency savings."

This dependence on retirement savings is also rising according to Vanguard research that reveals hardship withdrawals from workplace retirement plans increased from 2021 to 2022. About 80% of those withdrawals were taken by lower-income participants (defined as the participants with an annual income of between $30,000 and $75,000) to avoid losing their home or to pay for unexpected medical bills. Further, one-third of the participants who took a hardship withdrawal in 2022 had previously taken a withdrawal in 2021.

This data underscores an important challenge facing employees and employers alike: near-term financial needs may sabotage the long-term financial security and retirement outcomes of many Americans. And while today only 20% of workers have access to an emergency savings account at work, EBRI's survey found that more than 80% of those without such a benefit want one and would prioritize it above other benefits, such as health savings accounts and additional paid time off.

HOW EMPLOYERS CAN HELP: THE IN-PLAN OPTION

To help address this issue, the Secure 2.0 Act of 2022 offers plan sponsors a way to include an emergency-savings benefit, also known as pension-linked emergency savings accounts or PLESAs, as an add-on to an existing retirement plan program. The Act permits PLESAs to be added as of January 1, 2024.

Here are a few things to know about PLESAs:

- PLESAs are intended for non-highly-compensated employees (as defined by the IRS).
- Employees can contribute up to $2,500 (or a lesser amount determined by the plan sponsor) on an after-tax (Roth) basis.
- Employees may take withdrawals as frequently as monthly.
- Employers have the option of auto-enrolling employees in a PLESA up to a rate of 3% of compensation.
- Employers may match contributions to a PLESA, but must:
  - Match at the same rate that applies to any retirement plan match.
  - Make matching contributions to the participant's retirement account, not the PLESA.
- Employees are not required to document a hardship or immediate financial need to take a withdrawal.
- PLESA contributions must be held as cash in interest-bearing deposit accounts or in regulated principal preservation investment products.

While the intended goal of PLESAs is positive — to promote healthy saving habits while helping to preserve the retirement savings of employees — there remain many open questions about key aspects of the legislation including eligibility, employee and employer contributions, and distributions. The DOL and IRS have been directed to study emergency savings in defined-contribution plans and to report their findings to Congress, but the deadline for doing so isn't until December 29, 2029. For plan sponsors concerned about the complexity and lack of regulatory clarity around setting up and administering PLESAs, a standalone emergency savings product is an alternative.

OUT-OF-PLAN ALTERNATIVES

A growing number of retirement plan recordkeepers are partnering with plan sponsors to add out-of-plan (sometimes referred to as à la carte) emergency savings products to their menu of benefits. Financial wellness nonprofit Commonwealth interviewed plan recordkeepers and noted that eight out of nine recordkeepers offered or are planning to offer an emergency savings product.

One such program recently initiated by some plan sponsors allows employees to contribute a portion of their net pay to an account maintained by the company's 401(k) recordkeeper. Financial education modules and one-on-one financial coaching sessions are also being offered in conjunction with the program.

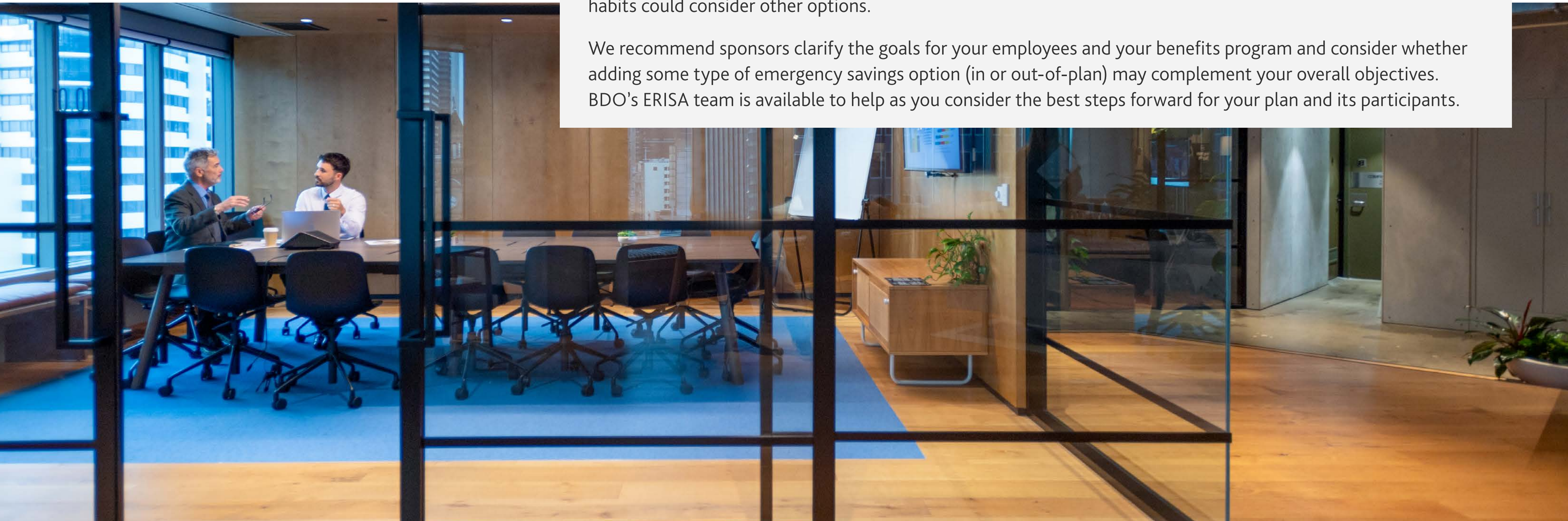
BDO Insight: Weigh the Pros and Cons

When considering either approach, plan sponsors need to think through what they are trying to achieve. If it is a behavioral shift they are seeking, the in-plan option may make sense because once participants reach the $2,500 contribution limit, any overflow of funds automatically goes into the participant's Roth retirement savings along with any employer matching contributions. In this way, plan sponsors are encouraging better short- and long-term saving habits, while also helping to reduce hardship withdrawals and loans from retirement plans along with the associated penalties and fees.

For other employers, particularly smaller companies, the out-of-plan option may be a more easily implemented choice because employers are not required to already have a retirement plan in place. Also, because standalone savings plans are not subject to ERISA, there are no regulatory hurdles, auto-enrollment, auto-escalation, or fiduciary obligations for sponsors. The relative simplicity of implementing these out-of-plan savings vehicles could offer an attractive option for smaller employers.

However, while out-of-plan products are attractive for their ease of use, they do not include an employer matching contribution feature. From a behavioral perspective, the out-of-plan product lacks the employee behavioral trigger that some employers want to achieve. Employers who are looking to modify employee savings habits could consider other options.

We recommend sponsors clarify the goals for your employees and your benefits program and consider whether adding some type of emergency savings option (in or out-of-plan) may complement your overall objectives. BDO's ERISA team is available to help as you consider the best steps forward for your plan and its participants.



New Requirement to Cover Long-Term Part-Time Employees in 401(k) Plans Enters Into Effect

The Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act of 2019) and the SECURE 2.0 Act of 2022 (collectively, SECURE) enacted a new mandate that, starting in 2024, long-term, part-time (LTPT) employees must be allowed to make salary deferrals into their employer's 401(k) plan.

The systems used by many 401(k) plan service providers are not ready for the required implementation starting with the first plan year beginning on or after January 1, 2024 (i.e., January 1, 2024, for calendar year plans).

Some executives may view this change as an issue that does not require their attention and that will be handled by their human resources (HR) staff and the 401(k) plan service providers. But not complying with the rules might be costly for the employer if corrective contributions for LTPT employees who were not allowed to participate are required, along with ancillary costs.

NEW MANDATE

For decades, tax-qualified retirement plans could exclude employees who work fewer than 1,000 hours of service per year, even if the employee worked for the employer for many years. Employees who worked over 1,000 hours generally could not be excluded from the plan (with certain non-hours-based exceptions). To improve access to workplace retirement savings plans, the 2019 SECURE Act required 401(k) plans to allow employees who have worked at least 500 hours in three consecutive years (based on employment with the employer from January 1, 2021, onward) to make elective deferrals to the plan. Thus, if an employee had 500 hours of service in 2021, 2022, and 2023 (but never had 1,000 hours of service per year), that employee must be allowed to make salary deferrals into the employer's 401(k) plans starting with the first plan year beginning on or after January 1, 2024. For plan years beginning in 2025 and later, SECURE 2.0 of 2022 reduces the three-year measurement period to two years.

On November 27, 2023, the IRS issued proposed regulations that employers can rely on to apply the LTPT employee rules until the final rules are issued.

AN EXAMPLE OF HOW THE RULES WORK

Let's assume a calendar year 401(k) plan has a requirement that employees must be age 21 and complete 1,000 of service before being eligible for plan participation that includes making elective deferrals and receiving company matching contributions. Starting in 2024, some employees who do not meet the 1,000-hour service requirement might be eligible to make salary deferrals. The employer is not required to make matching contributions or any other employer contributions for LTPT employees who make salary deferrals.

Counting the hours worked to determine plan eligibility is not new and the rules are essentially the same for counting 1,000 hours and 500 hours. Hours for new employees should be counted for 12 months following their date of hire, but the measurement period can be switched to the plan year for administrative ease. However, while the 1,000-hour requirement is a standalone measure for each year, the 500-hour count is relevant for two or three years, depending on the plan year under evaluation. Therefore, for a calendar year plan beginning January 1, 2024, the hours are counted for 2021, 2022, and 2023. Any employee whose count is 500 or more but less than 1,000 in each of those three years should be allowed to make elective deferrals into the calendar year plan as of January 1, 2024.

As a further example, assume Susan was hired on June 1, 2021, by an employer that sponsors a calendar year 401(k) plan. On December 31, 2021, the first plan year end after Susan's hire date, the employer switches her hours worked to be measured based on the plan year. Year One for Susan runs from June 1, 2021, through May 31, 2022. Year Two for Susan runs from January 1, 2022, through December 31, 2022, and Year Three for Susan runs from January 1, 2023, through December 31, 2023. Susan worked 500 hours in Year One, 680 hours in Year Two, and 520 hours in Year Three. Therefore, effective January 1, 2024, she should be allowed to make elective deferrals under the plan. Note that the switch from counting hours based on Susan's date of hire anniversary to using the plan year as her eligibility computation period causes the hours she worked from January 1, 2022, through May 31, 2022, to be double counted in both her first and second year.

Even though vesting schedules have no relevance to Susan's elective deferrals (since she is always 100% vested in her own contributions), she will receive a year of vesting credit for each year after 2021 that she works at least 500 hours (i.e., Susan has three years vesting credit if she became eligible for employer contributions in 2024). This would be significant if she subsequently becomes eligible to participate in the plan for a reason that is not solely on account of being an LTPT employee. Once an individual is eligible for the plan, they remain eligible and do not have to requalify to participate.

For the 2025 plan year, the period from June 1, 2022, through May 31, 2022, will drop out of the determination. Additionally, the period from January 1, 2022, through December 31, 2022, will drop out of the determination because of the change made by SECURE 2.0 to look back only two years instead of three. Accordingly, Susan's 2025 plan eligibility as an LTPT employee will be based on her hours worked during the 2023 and 2024 plan years.

The future years' determination is complicated, especially if the employee's hours worked fluctuate above and below 1,000 hours.

WHY SHOULD I BE CONCERNED?

While employers are not required to match the LTPT employee deferrals and LTPT employees are excluded from the annual tests that otherwise apply to all employees (e.g., coverage, nondiscrimination, and top-heavy requirements), there might be some increased cost to the plan sponsor for including LTPT employees in the 401(k) plan. Employers should consider the following potential increases in plan cost due to the new LTPT employee mandate.

- **Increased Plan Audit Expense:** The additional participants due to LTPT employee status must be counted when determining if the 401(k) plan must have an annual independent audit of the plan's financials. Starting with the 2023 plan year, 401(k) plans that have more than 100 participant accounts as of the first day of the 2023 plan year must have an annual independent audit. Before 2023, 401(k) plan participants who were eligible to make salary deferrals were counted as participants — even if they did not contribute anything — for purposes of counting the number of participants. The DOL changed the rules starting in 2023, among other things, to include only those with account balances as participants. Keep in mind that the number of participants can be decreased by taking advantage of rules that allow distributions of small account balances (accounts valued at less than $7,000 starting in 2024) to former participants.
- **Increased Plan Administration Costs:** The time spent internally and by plan service providers increases as the number of plan participants increases, particularly if recordkeeping for a new category of participants is necessary. The LTPT employee rules raise unique recordkeeping challenges necessitating new programing and new procedures to stay in compliance.
- **Costly Corrective Actions:** The employer must take steps to correct any instance of when an employee that is eligible to make elective deferrals was not notified of being eligible. Increasing the number of eligible employees increases the possibility of someone being missed. But the immediate concern is based on feedback that many administration systems are not ready for the implementation of the LTPT rules as early as January 1, 2024 (for calendar year plans). Any delay in communicating the eligibility to LTPT employees that causes a delay of payroll deductions of elective deferrals beyond their eligibility date would be an operational failure that would need correction under the IRS's Employee Plans Compliance Resolution System (EPCRS). While corrective contributions to make up the employee's missed contribution are not always required, notices would need to be provided to any participant that had a missed deferral period to advise them that their future retirement savings might need adjustment due to the delay in making elective deferrals.
- **Decreased Forfeitures:** LTPT employees earn vesting credit for each year after 2021 during which they work at least 500 hours but less than 1,000 hours. While the vested percentage has no impact on the years the employer does not make contributions on the employee's behalf, vesting as an LTPT employee carries over to any years that the employee becomes eligible for employer contributions.
- **Operational Compliance Before Plan Amendment Deadline:** For a 401(k) plan to be "qualified" (that is, eligible for favorable tax treatment), it must comply with the statutory requirements in both form and in operation. SECURE provides that the written plan document is not required to be amended until the end of the 2025 plan year. However, the plan must operate in compliance with the applicable changes in the law for all plan years, starting with the effective date of the change. Since the LTPT rules took effect for plan years beginning on or after January 1, 2024, the 401(k) plan would need to be operated with those rules starting in 2024, even though a formal, written plan amendment is not required until the end of the 2025 plan year. Therefore, any decisions regarding compliance with the LTPT employee provisions should be documented and the proper procedures and controls put in place.

While plan sponsors might rely on their 401(k) plan service providers to identify eligible LTPT employees, liability for noncompliance remains on the employer. The risk associated with not allowing LTPT employees to make elective deferrals to a 401(k) plan can be avoided if the plan lowers the 1,000-hour requirement to not more than 500 hours or determines eligibility on the elapsed time method instead of the counting hours method of determining eligibility to make salary deferrals under the plan.

SECURE provides numerous exceptions from coverage, nondiscrimination, and top heaviness tests for employees who participate in the plan solely on account of the LTPT employee provisions. Any employee that satisfies the more generous plan document provisions will not qualify for the confusing rules that otherwise apply to LTPT employees. Still, avoiding LTPT employee status altogether might be cost effective.

BDO can assist your review of your 401(k) plan provisions to evaluate the cost benefit analysis of implementing the LTPT employee rules.

CONTACT US

ERIN BREIT
Assurance Principal
Employee Benefit Plans
ebreit@bdo.com

CHELSEA SMITH
Assurance Professional Practice Senior Manager
Employee Benefit Plans
csmith@bdo.com

NORMA SHARARA
GES Managing Director
Specialty Tax Services
nsharara@bdo.com

NICOLE PARNELL
GES Managing Director
Specialty Tax Services
nparnell@bdo.com

At BDO, our purpose is helping people thrive, every day. Together, we are focused on delivering exceptional and sustainable outcomes — for our people, our clients and our communities. Across the U.S., and in over 160 countries through our global organization, BDO professionals provide assurance, tax and advisory services for a diverse range of clients.

BDO is the brand name for the BDO network and for each of the BDO Member Firms. BDO USA, P.C., a Virginia professional corporation, is the U.S. member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms: www.bdo.com

Material discussed in this publication is meant to provide general information and should not be acted on without professional advice tailored to your needs.

© 2024 BDO USA, P.C. All rights reserved.