ERISA Roundup

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

Q4 2023

A Note from BDO's ERISA Practice Leaders

Many of us are welcoming Spring weather and a renewed sense of energy for 2024. BDO's ERISA Center of Excellence has been working diligently to bring you a fresh set of insights around the latest topics in employee benefit plans.

This first quarter 2024 ERISA Roundup is a compilation of our most recent insights and podcast episodes. It includes a discussion of key implications and compliance concerns for plan sponsors navigating SECURE Act and SECURE 2.0 changes to eligibility for "long-term part-time" employees in 401(k) plans.

We invite you to stay current with BDO and follow along with our regular ERISA 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.

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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

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.

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.

JUNE

- **28 / Action:** 401(k) plans with publicly traded employer stock must file SEC Form 11-K with the Securities and Exchange Commission by June 28 or file an extension on SEC Form 12b-25.
- **30 / Action:** Highly compensated employees who fail ADP/ACP test for prior plan year must have refunds processed by June 30, if an eligible automatic contribution arrangement (EACA).

JULY

- **15 / Action:** 401(k) plans with publicly traded employer stock that requested a 15-calendar day extension (SEC Form 12b-25) for the SEC Form 11-K must file the SEC Form 11-K with the Securities and Exchange Commission by July 15.
- **15 / Fund:** Possible second quarter 2024 contribution due for defined benefit pension plans by July 15.
- **31 / Action:** File IRS Form 5500, Annual Return/Report of Employee Benefit Plan, and IRS Form 8955-SSA, Annual Registration Statement Identifying Separated Participants with Deferred Vested Benefits, for the 2023 plan year by July 31.
- **31 / Action:** To request an extension of time to file IRS Form 5500, file IRS Form 5558 by July 31.

UPCOMING WEBINAR

Accounting, Audit, and Regulatory Updates Impacting Retirement Plans

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Join BDO and our thought leaders who will provide an update on key developments in Accounting, Audit, and Regulatory Guidance pertaining to retirement plans.

At the end of this session, participants will be able to:

- Identify impact of recent accounting developments on retirement plans.
- Discuss newly effective auditing standards on retirement plans.
- Demonstrate knowledge of legislative and regulatory changes impacting retirement plans.

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1 CPE Credit in the field of Auditing

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

BDO TALKS ERISA

Our ERISA Center of Excellence hosts a 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**.

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.

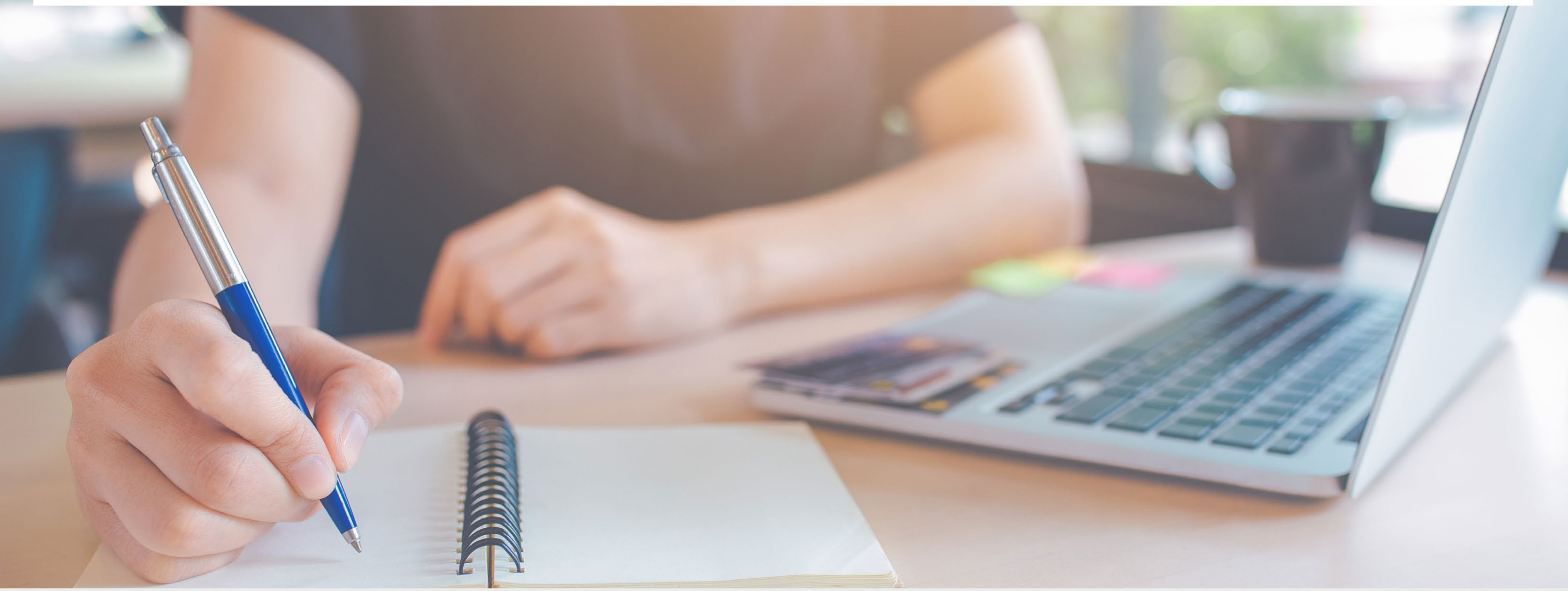
- **Increased Plan Audit Expense:** The additional participants due to LTPT employee status must be counted when determining if the 401(k) plan must have an annual independent audit of the plan's financials. Starting with the 2023 plan year, 401(k) plans that have more than 100 participant accounts as 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.



Complying with SECURE Act Changes to Long-Term Part-Time Employee Eligibility and IRS Form 5500

NEW ELIGIBILITY OPPORTUNITIES FOR LONG-TERM, PART-TIME EMPLOYEES

Prior to the SECURE Act of 2019 and SECURE 2.0 Act of 2022 (collectively SECURE), employers could exclude employees from their tax-qualified defined contribution plans based on the number of hours they worked per year. Typically, this meant that part-time employees were ineligible to contribute to their employer's retirement plan — no matter how many years they had worked for their employer. An **IRS Employee Plans Newsletter issued on January 26, 2024**, defined LTPT employees as workers who have worked at least 500 hours per year in three consecutive years, although the consecutive year condition will be reduced to two years in 2025.

SECURE expanded LTPT employee access to employer retirement plans by requiring 401(k) plans to allow employees that meet the LTPT requirements to make elective deferrals starting with the first plan year beginning on or after January 1, 2024. Employers are not required to make employer contributions for LTPT employees.

However, the burden of identifying, notifying, and enrolling these newly eligible LTPT employees falls on the employers. Failing to inform LTPT employees of their eligibility as of January 1, 2024, may have resulted in non-compliance. To rectify any compliance issues, employers can consider using the IRS amnesty program known as the **Employee Plans Compliance Resolution System (EPCRS)**.

For a more comprehensive explanation of SECURE's impact on retirement plans, please refer to our earlier insight **New Requirement to Cover Long-Term Part-Time Employees in 401(k) Plans Enters Into Effect.**

It is essential to understand this new requirement because LTPT employee eligibility may affect two other administrative functions for plan sponsors: Form 5500 filing and the annual employee benefit plan audit requirement.

A KEY CHANGE WHEN COUNTING PARTICIPANTS FOR FORM 5500

Prior to 2023, IRS Form 5500 — an essential part of ERISA's reporting and disclosure framework — required defined contribution retirement plan sponsors to include employees who were eligible to make elective deferrals on the first day of the plan year. In most organizations, LTPT employees would be excluded from this headcount unless the employer's plan allowed them to make contributions to the retirement plan.

Now, employers need only include participants with an account balance in the defined contribution retirement plan as of the first day of the plan year (but, for new plans, the participant account balance count is determined as of the last day of the first plan year). This may sound like a simple change, but the potential increase in participants who are LTPT employees complicates the matter.

THE IMPACT ON A PLAN'S AUDIT REQUIREMENT

An organization's obligation to have an annual audit of its retirement plan is dependent on the number of plan participants as of the first day of the plan year.

Beginning with the 2023 plan year, defined contribution plans that have more than 100 participant accounts as of the first day of the 2023 plan year generally must have an annual independent audit. Before 2023, all plan participants who were eligible to make salary deferrals were included in headcounts as participants even if they had not made any plan contributions. The DOL changed the rules starting in 2023 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, if the defined contribution plan adopted these provisions.

The audit requirement of plans with 100 or more employees may change since employees without account balances are no longer counted. An organization may find that the defined contribution plan no longer requires an audit if eligible employees have not contributed to the 401(k) plan, but the audit requirement may be triggered when previously excluded LTPT employees begin to make elective deferrals.

NAVIGATING THE NEW NORMAL FOR CERTAIN RETIREMENT PLANS

The LTPT employee rules take effect for plan years beginning on or after January 1, 2024 (for calendar-year end plans). If your organization missed the deadline to allow LTPT employees to participate in your plan, the good news is that there is a path to compliance. However, implementing these complicated changes in the law requires in-depth knowledge of the complex issues surrounding tax-qualified retirement plans. Experienced consultants can provide guidance and support throughout the process in the following ways:

- Analyze plan documents and employee data to identify any compliance gaps or issues that need to be addressed
- Engage in detailed discussions with plan sponsors to explain the intricacies of the changes and helping them understand the necessary steps to ensure compliance
- Facilitate communication with service providers to aid in a smooth transition and implementation of any required changes
- Calculate corrective actions required to rectify any non-compliance issues and confirm future compliance
- Guide the employer in enrolling in the IRS's amnesty program (EPCRS), if necessary, to self-report non-compliance issues
- Help plan sponsors track the path taken to incorporate the necessary changes into the plan documents, to ensure ongoing compliance and avoid future issues
- Discuss Form 5500 preparation considerations, including participant head count

For questions about plan compliance with these and other provisions of SECURE and ERISA, as well as benefit plan audits, please contact our **Employee Benefit Plan Audit team**.

New DOL Regulations May Bring Clarity to ESOP Valuation Process

While a legal framework for employee stock ownership plans (ESOPs) was established by the Employee Retirement Income Security Act of 1974 (ERISA), formal guidance for determining the fair market value (FMV) of private company shares sold to an ESOP has not been issued in the 50 years since then. The U.S. Department of Labor (DOL) is now poised to issue proposed regulations (perhaps as early as March 2024 according to the DOL's most recent regulatory agenda) clarifying what constitutes adequate consideration for such shares, which has been a long-standing concern for the ESOP community.

LACK OF GUIDANCE VEXES THE ESOP COMMUNITY

Historically, the ESOP community has relied on the DOL's audit findings, process agreements, and the courts for interpretive guidance on the valuation process, which has led to inconsistencies. This leaves ESOP trustees unsure of how to determine an appropriate share price. Using the correct share price for the sale of private company stock to the ESOP is of paramount importance since the sale would be a prohibited transaction if the ESOP paid more than "adequate consideration" for the shares. Technically, the sale of employer stock to the ESOP is an ERISA prohibited transaction, but a statutory exemption allows such sales, so long as the ESOP pays no more than "adequate consideration" for the shares.

Additionally, the industry has dealt with costly litigation and investigations associated with ESOP valuations. According to the **National Center for Employee Ownership**, ESOP court cases have cost defendants an estimated $385.5 million over the past decade. Between 2007 and 2017, the **Employee Benefits Security Administration** found ERISA violations in more than 1,000 cases; ESOP valuation and loan term issues were the most common violations found.

REQUESTED CLARIFICATION AND SECURE 2.0

Over the years, ESOP groups requested clarification on this issue. Enacted on December 29, 2022, the SECURE 2.0 Act requires the DOL to issue regulations for what constitutes "adequate consideration" for sales of private company stock to an ESOP for purposes of the ERISA statutory exemption.

During 2023, the DOL met with ESOP industry professionals to gather preliminary input about the proposed regulations. Early discussions indicate that the regulatory focus is more about the general valuation process than on issuing specific rules that might limit the ability of ESOP trustees and other advisors to exercise their professional judgment.

INTERIM BEST PRACTICE CONSIDERATIONS

While the industry awaits the DOL's proposed regulations, the following are some best practices to consider when seeking to mitigate ESOP valuation risks:

- Work with skilled advisors who have deep experience with ESOP valuation analysis.
- Interview and thoroughly vet a potential ESOP trustee prior to engaging them. Look for a trustee who has developed a process and strong track record for determining FMV of private company stock.
- Use a trustee who has no ties to the company being appraised (i.e., is independent) and has experience with similar size companies in the company's industry.
- Hire valuation firms that understand both ESOPs and the industry of the company sponsoring the ESOP.

An ESOP valuation process should be transparent and balanced for all stakeholders (i.e., the trustee, sponsor, and ESOP participants). It is crucial to address potential valuation concerns at the earliest stages of ESOP planning. BDO's multidisciplinary teams include the **ESOP Advisory team at BDO Capital Advisors**[1] that can help you fully explore your ESOP potential, from preliminary analyses to full implementation, and **ERISA compliance professionals** who can assess current employee benefit programs for compliance and risk mitigation, providing advice that helps fiduciaries uphold their responsibilities.

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