ThompsonKnight

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COVID-19 AND EMPLOYEE BENEFIT PLANS: FREQUENTLY ASKED QUESTIONS

The COVID-19 pandemic has resulted in economic hardships for many employers and employees. These challenges, along with a number of legislative and administrative developments, have led employers to consider making adjustments to their employee benefit programs. To assist our clients with assessing the requirements and considerations for their employee benefit programs, we have answered some commonly-asked questions below.

QUALIFIED RETIREMENT PLANS

- **Can we permit plan participants to take coronavirus-related distributions?**

The Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") permits plan sponsors to allow participants to take coronavirus-related distributions ("CRDs") from qualified retirement plan accounts. A CRD is any distribution, not to exceed $100,000, that is made on or after January 1, 2020 and before December 31, 2020 to a qualifying individual:

  - Who is diagnosed with COVID-19 or SARS-CoV-2;
  - Whose spouse or dependent is diagnosed with COVID-19 or SARS-CoV-2; or
  - Who experiences adverse financial consequences as a result of being quarantined, being furloughed or laid off or having work hours reduced due to such virus or disease; being unable to work due to a lack of child care due to the virus or disease; closing or reducing hours of a business owned or operated by the individual due to the virus or disease; or such other factors determined by the Secretary of the Treasury.

CRDs are more favorable than hardship distributions because the 10% early withdrawal penalty does not apply. Further, income attributable to such distributions is subject to tax over a three-year period, and the participant may recontribute the funds to an eligible retirement plan within three years without regard to typical annual contribution limits. Plan sponsors wanting to allow participants to request CRDs should coordinate with their recordkeepers to update their plan procedures. Although CRDs can be offered currently, adoption of a plan amendment is not required until the end of the 2022 plan year.

- **May an employee take a hardship withdrawal from his or her 401(k) plan to cover expenses that arise as a result of the COVID-19 pandemic?**

Most 401(k) plans offering hardship withdrawals utilize the IRS's safe harbor rules to determine whether participants have an immediate and heavy financial need entitling them to a hardship withdrawal. There is no specific safe harbor that would allow a participant to take a hardship withdrawal solely due to expenses arising from the COVID-19 pandemic. However, an employee could be able to request a

hardship withdrawal if he or she incurs expenses due to the COVID-19 pandemic that fall within one of the general safe harbors. The types of expenses that may give rise to a hardship withdrawal include certain medical expenses, payments necessary to prevent eviction from the employee's primary residence or foreclosure on a mortgage of that residence, and certain funeral expenses. In addition, if the plan permits, hardship withdrawals may be taken to cover expenses or losses (including loss of income) that are incurred on account of a federal disaster, provided the employee lives or works in an area designated by FEMA for individual assistance. Employers should review their plan documents and consult with their benefits counsel to determine whether and the extent to which their 401(k) plans allow hardship distributions.

- **Are participants entitled to plan loan relief as a result of the COVID-19 pandemic?**

The CARES Act allows plan sponsors to expand access to plan loans for "qualifying individuals" (those individuals eligible for CRDs as described above). The maximum loan that can be taken by a qualifying individual is increased to the lesser of $100,000 or 100% of an individual's vested account balance. In addition, qualifying individuals with outstanding loan balances may be allowed to delay loan repayments for up to one year. Plan sponsors wanting to implement these changes should coordinate with their recordkeepers to update their plan procedures. Plan documents can be amended at a later date.

- **Are participants required to take minimum distributions for 2020?**

The CARES Act waives required minimum distributions that otherwise would have to be made during 2020 from defined contribution plans, IRAs, and governmental section 457(b) plans.

- **Can we save costs by suspending or reducing employer contributions to our 401(k) or 403(b) plan?**

If a plan is a safe harbor plan, safe harbor employer contributions can only be suspended or reduced mid-year if either (1) the plan sponsor is operating at a qualifying economic loss for the applicable plan year, or (2) the plan's safe harbor notice included a statement that the plan could be amended during the plan year to reduce or suspend safe harbor contributions. Assuming the plan can be amended to suspend or reduce safe harbor contributions, participants must be provided with at least 30 days' advance notice and given an opportunity to change their deferral elections before the change or suspension takes effect.

If a plan is not a safe harbor plan, contributions generally can be suspended or reduced. Plan sponsors should carefully review the terms of their plans and consult with benefits counsel to determine the extent to which contributions can be suspended or reduced and whether a plan amendment is required.

- **Can we delay funding of our employer contributions?**

  Yes, although the rules are different for defined contribution and defined benefit plans:

  - *Defined Contribution Plans*. Notice 2020-18 changed the due date for filing Federal income tax returns that were otherwise due on April 15, 2020 to July 15, 2020. This also extended the deadline for making employer contributions with respect to the 2019 plan year until July 15, 2020. Therefore, if an employer is a corporation with an April 15, 2020 due date for filing its 2019 Form 1120, the deadline for the employer to make contributions for 2019 to its defined contribution plan is July 15, 2020. However, if the employer files for an extension until October 15, 2020 to file its tax return, then October 15, 2020 is the applicable deadline for making the contribution.
  - *Defined Benefit Plans*. The CARES Act postpones the deadline for making any contributions due in 2020 to a single employer defined benefit plan until January 1, 2021. Even though the deadline is extended until January 1, 2021, interest will accrue on any delayed payments starting on the date the payments would have otherwise been due. This will result in larger contributions being made to the plan.

- **Can we save costs by freezing or reducing future benefit accruals to our defined benefit plan?**

In consultation with their plan actuaries and benefits counsel, plan sponsors may amend their defined benefit plans to freeze or reduce future benefit accruals subject to any collective bargaining agreements that may apply. However, defined benefit plans subject to ERISA are generally obligated to provide certain plan participants with a 45 days' advance notice informing them of the freeze or reduction. Even if benefits under a defined benefit plan subject to ERISA are frozen or reduced, obligations to fund the plan continue.

- **What if we just terminate our plan?**

There are a number of legal requirements and administrative complexities associated with terminating a plan that may make a plan freeze a better option. Upon termination of a qualified retirement plan, all participants must become fully vested in their plan benefits. An employer that terminates a 401(k) plan generally may not establish a new plan within 12 months following the termination. With respect to defined benefit plans, recent market volatility and changes in interest rates may have affected plans' funding status, so any discussion of plan termination should be carefully considered in consultation with plan actuaries and investment advisors. The termination of a defined benefit plan subject to the Pension Benefit Guaranty Corporation also requires 60 days' advance notice to participants and beneficiaries.

- **If we furlough some employees, how will that affect our retirement plan?**

Furloughs may affect a furloughed employee's vesting service calculation, depending on the specific method used by the retirement plan to calculate vesting service. Also, a period of no or reduced compensation may affect a furloughed employee's benefit calculation. Retirement plan participants

generally cannot commence receiving their retirement plan benefits until they incur an actual termination of employment.

- **Are there any special considerations for plan fiduciaries during times of market volatility?**

During times of market volatility, fiduciaries of qualified retirement plans subject to ERISA should remain aware of their duties to act prudently, to diversify plan assets, and to comply with plan provisions. For example, these duties may require fiduciaries to reconsider investment strategies, rebalance plan assets, seek expert investment advice, or consider delaying or canceling any upcoming blackout periods. Fiduciaries should continue to exercise and document their prudent fiduciary practices.

- **How are the adoption deadlines for 403(b) plans and pre-approved defined benefit plans affected?**

The IRS is extending the last day of the initial remedial amendment period for 403(b) plans from March 31, 2020 to June 30, 2020 so that plan sponsors have until the end of June to update their 403(b) plan documents. The IRS also is extending certain deadlines applicable with respect to pre-approved defined benefit plans from April 30, 2020 to July 31, 2020. Plan sponsors utilizing pre-approved defined benefit plan documents will have until the end of July to adopt updated plan documents.

EXECUTIVE COMPENSATION PROGRAMS

- **We missed the March 15th deadline for paying our bonuses. Will our employees be subject to penalties under Code Section 409A?**

Many bonus plans are designed to satisfy the "short-term deferral" exception to Internal Revenue Code Section 409A by requiring payment by March 15th following the year in which the bonus became vested. If an employer missed its usual March 15th deadline, the regulations provide some relief so that the bonus may still be considered a "short-term deferral" as long as (1) making the payment by the deadline was administratively impracticable due to an unforeseen event or would have jeopardized the employer's ability to continue as a going concern, and (2) payment is made as soon as possible after these conditions are alleviated.

- **Can participants' contributions to a nonqualified deferred compensation plan be suspended? Can they take hardship withdrawals from the plan?**

Generally, a participant's deferral elections under a nonqualified deferred compensation plan must be irrevocable. However, if permitted by the applicable plan document, a participant's deferral election may be cancelled in the event of an unforeseeable emergency. A plan document can further provide that participants may receive distributions in the event of an unforeseeable emergency. The COVID-19 pandemic may result in an unforeseeable emergency for a participant if it creates a severe financial hardship that cannot be satisfied through other resources. Employers should review their plan documents to determine what their nonqualified deferred compensation plans permit in this regard and whether amendments may be desirable.

- **Can we terminate our nonqualified deferred compensation plan so that we can distribute benefits to participants?**

Although Internal Revenue Code Section 409A permits voluntary plan terminations if certain requirements are satisfied, one such requirement is that the termination cannot occur proximate to a downturn in the financial health of the employer. Accordingly, employers should carefully review their circumstances with benefits counsel to determine whether a plan termination is permissible.

HEALTH AND WELFARE PLANS

- **What coverage changes are we required to make to our group health plan as a result of the laws recently passed?**

The recently enacted Families First Coronavirus Relief Act requires group health plans to cover, without cost-sharing, costs related to diagnostic testing for COVID-19. Prior authorization and other medical management requirements also must be waived with respect to COVID-19 diagnostic testing services. The CARES Act passed last week requires that group health plans cover certain preventive services and vaccines related to COVID-19. Employers should work with their insurers or third party administrators to implement these requirements.

- **Can we add telehealth benefits to our high deductible health plan?**

The CARES Act allows high deductible health plan participants with health savings accounts to receive telehealth free of cost-sharing for plan years beginning on or before December 31, 2021. Employers may consider adding telehealth benefits to their high deductible health plans (or removing cost-sharing from telehealth benefits already provided in their high deductible health plans) as part of their COVID-19 strategy.

- **What changes have been made with respect to over-the-counter drugs?**

Effective for expenses incurred after December 31, 2019, the CARES Act eliminates the Affordable Care Act's ban on pre-tax reimbursement of expenses incurred for over-the-counter drugs not prescribed by a physician. This means that health savings accounts, Archer medical savings accounts, and group health plans (including health flexible spending arrangements and health reimbursement arrangements) may now reimburse such expenses.

- **If we furlough some employees, what health and welfare plan issues do we need to consider?**

Whether an employee on furlough remains eligible for health and welfare plans depends on the terms of the specific plans. The terms of the governing plan document will have to be reviewed to determine its eligibility requirements. It is typical for eligibility provisions to require the employee to be actively at work some specified number of hours per week. Loss of health plan coverage on account of a furlough may give rise to a COBRA qualifying event. Plan sponsors wishing to modify plan eligibility provisions need to work with their benefits counsel and the plan's insurance carrier, or in the case of a self-funded medical plan, its stop loss carrier.

- **If we terminate some employees, can we choose to pay a portion of their COBRA continuation coverage?**

Employers may subsidize COBRA premiums, but in the case of a self-funded medical plan, any COBRA subsidies should not discriminate in favor of the highly compensated. Also, a short-term COBRA subsidy may create complications when the subsidy ends and the former employee then seeks coverage on either a healthcare exchange or a spouse's health plan.

Thompson & Knight is closely monitoring developments related to the COVID-19 pandemic and its impact on our clients. Visit the Firm's TK COVID-19 Updates website for the latest Client Alerts addressing coronavirus-related legal issues and best practices.

If you have any questions about the information contained in this Client Alert, please contact the Thompson & Knight attorney with whom you regularly work or one of the attorneys listed below.

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