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IRS rights the apple cart for multiple-employer plans

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In this article

Proposal implements statutory exception | PEP provider duties | Coordination with EPCRS | Prior proposal rescinded | Request for comments |Related resources

New IRS proposed regulations would implement the statutory exception to the “one bad apple” rule for defined contribution (DC) multiple-employer plans (MEPs), as provided in the Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019 (Div. O of Pub. L. No. 116-94). The exclusion allows MEPs to maintain their tax-qualified status despite a participating employer’s errors. The proposal sets conditions for MEPs to use the exception and provides a framework to address a participating employer’s failures, including detailed notice requirements. The proposal also explains the administrative duties of a pooled plan provider — the administrator of new type of MEP, known as a pooled employer plan (PEP), established by the SECURE Act. Pending final regulations, IRS will allow reliance on the proposal. The agency is accepting comments through May 27 and has scheduled a public hearing for June 22.

Proposal implements statutory exception

Prior to the SECURE Act, MEPs were generally available only to unrelated employers that had a common business nexus beyond adopting the plan. The SECURE Act created PEPs for employers with no common nexus. PEPs and other MEPs are subject to the “one bad apple” rule (called the “unified plan rule” in the proposal), which says a MEP can be treated as violating applicable Internal Revenue Code (IRC) requirements for tax-qualified plans if a single participating employer fails to take required actions. This can be particularly problematic due to the lack of common control among a MEP’s unrelated participating employers.

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The SECURE Act makes an exception to the one-bad-apple rule for PEPs and other MEPs. Under the statute, one participating employer's failure won't jeopardize the MEP if the plan document provides the following:

- The MEP will spin off assets attributable to employees of a noncompliant employer, unless the Treasury Department determines that keeping those assets in the plan would be in the employees' best interest.
- The noncompliant employer (called an "unresponsive participating employer" in the proposal) will be responsible for any liabilities with respect to its participating employees and their beneficiaries.

Not all MEPs qualify. Only certain MEPs — called "section 413(e) plans" in the proposal — are eligible for this exception, including DC plans qualified under IRC Section 401(a) and certain individual retirement account (IRA) arrangements, but not Section 403(b) plans.

Required plan language

The proposed regulations require a MEP to have the following additional plan language to qualify for the one-bad-apple exception:

- A description of the notices the plan administrator will send about a participating employer's failure (see Required notices)
- A statement that the plan administrator will send the required notices by specified deadlines for each type of failure by a participating employer
  - For a failure to provide information: 12 months after the end of the plan year for which the information is necessary to determine compliance with applicable IRC requirements
  - For a failure to take action: 24 months after the end of the plan year in which the failure occurs
- A description of the actions the plan administrator will take if an unresponsive participating employer fails to take appropriate remedial action or initiate a spinoff of amounts attributable to its employees to a separate single-employer plan by the final specified deadline
- A statement that if an unresponsive participating employer fails to act by the final deadline, its employees will be vested in their benefits

IRS intends to provide model plan language after finalizing the regulations.

Participating employer failures and remedial actions

The proposal contemplates two categories of participating employer failures:

- **Failure to provide information.** This occurs when an employer fails to respond in a timely manner to the plan administrator's reasonable request for data, documents or any other information the plan

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administrator "reasonably believes is necessary to determine whether a section 413(e) plan is in compliance" with applicable IRC provisions.

- **Failure to take action.** This occurs when an employer fails to comply in a timely manner with the plan administrator's reasonable request to "take an action needed for the section 413(e) plan to satisfy" an applicable IRC provision.

To remedy these errors, the employer would provide the requested information or take the requested action, as applicable. For instance, for a failure relating to missed elective contributions, the employer would make corrective contributions.

If a plan administrator's request is unreasonable — that is, because it gives the participating employer insufficient time to provide information or take action — failure to respond to the request would not be a participating employer failure under the proposed rule.

A failure to provide information may become a failure to take action if (i) an employer supplies the requested information; (ii) based on this information, the plan administrator determines that the employer failed to satisfy an applicable IRC requirement; and (iii) the employer fails to respond to the plan administrator's request to fulfill the requirement.

Required notices

When a participating employer has a failure, the plan administrator must provide a series of notices:

- **First notice.** The first notice must describe the failure, the actions the employer must take to remedy the failure and the employer's option to initiate a spinoff to a single-employer plan. The notice must also explain that unless the employer takes action, its employees won't have any future contributions made on their behalf, and individuals responsible for the failure may face adverse tax effects.
- **Second notice.** If the employer takes no action within 60 days after the first notice, the plan administrator has 30 days to deliver a second notice. This notice must include all of the information in the first notice, plus a statement that if the employer takes no action within 60 days, a final notice will be distributed to participants and the Department of Labor (DOL).
- **Final notice.** If the employer fails to take action within 60 days after the second notice, the plan administrator has 30 days to deliver a final notice to the employer, the employer's participants, beneficiaries of deceased participants, alternate payees and DOL. The notice must include all of the information in the first notice, specify that the final deadline for the employer to take action is 60 days after delivery of the final notice and explain that the employer's participants and DOL are also receiving the notice.

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Combined first and second notice. When a failure to provide information becomes a failure to take action (see Participating employer failures and remedial actions), the proposal would permit combining the first and second notices for the failure to take action if the plan administrator:

- Makes the request to take action "as soon as reasonably practicable" after determining the employer failed to satisfy an applicable IRC requirement
- Provides the combined notice within 24 months after the end of the plan year in which the failure to take action occurred

IRS emphasizes that it can pursue appropriate remedies against any person responsible for an unresponsive participating employer's failure to take action, such as by treating that person's distribution from the MEP as ineligible for rollover.

Employer-initiated spinoff

The intent of the required notices is to prod the unresponsive employer into action. As an alternative to remedying the failure, the unresponsive participating employer may initiate a spinoff of employee balances to a separate single-employer plan of the same type as the MEP (i.e., qualified plan or IRAs) maintained by that employer. The deadline for the employer to initiate the spinoff (or take remedial action) is 60 days after the delivery of the final notice.

The employer initiates the spinoff by directing the plan administrator to spin off the assets attributable to the employer's employees to the new plan. The plan administrator must then implement and complete the spinoff "as soon as reasonably practicable." The administrator will be deemed to satisfy this requirement if the spinoff is completed within 180 days after the date the employer initiates the spinoff.

The proposal notes that the new plan will be considered to fail to meet the requirement that triggered the spinoff.

MEP-initiated spinoff

If an unresponsive participating employer fails to take remedial action or initiate a spinoff within 60 days after delivery of the final notice, the proposal would require the plan administrator take the following steps as soon as reasonably practicable:

- Stop accepting contributions from the employer and its employees
- Provide notice to the employer's participating employees and their beneficiaries explaining that no further contributions will be made on their behalf, all amounts attributable to service with the unresponsive participating employer are fully vested, and further information about the disposition of their accounts will be forthcoming
- Provide the employer's participating employees and their beneficiaries an "effective opportunity" (based on the facts and circumstances) to make an election to either have their accounts directly rolled over into an eligible retirement plan or remain in the MEP. However, the option to remain in the

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MEP is not available to the participant if the MEP document includes provisions on mandatory cashouts, and the participant's account would be cashed out under those provisions if the participant had a severance from employment.

Participants with balances above the mandatory cashout limit who make no affirmative election would be treated as if they had chosen to leave their funds in the MEP. These individuals would remain subject to the ordinary distribution rules, which generally prevent withdrawals of employee deferrals before termination of employment (unless the plan permits in-service withdrawals at or after age 59-1/2). The proposal would allow the plan administrator — absent actual knowledge to the contrary — to rely on the participant's representation that a separation from service has occurred.

In addition, any portion of a participant's account that is not an eligible rollover distribution must be paid directly to the participant. For example, any payment that is a required minimum distribution under IRC Section 401(a)(9) may not be rolled over or remain in the plan.

If a participant's account consists of amounts attributable to employment with more than one participating employer and the plan doesn't separately account for those amounts, then the entire account balance is attributed to the participant's most recent employment with a participating employer. For participants whose most recent employment was with the unresponsive employer, all amounts in the participant's account become immediately vested and subject to the proposal's distribution rules.

Electronic disclosure

All required notices and elections provided to or made by participants may be in written or electronic form, subject to IRS's electronic disclosure requirements.

PEP provider duties

As required by the SECURE Act, the proposal spells out a PEP provider's administrative duties. In addition to meeting DOL's registration requirements, pooled plan providers must generally perform all administrative duties that "are reasonably necessary to ensure that the plan meets any applicable requirement under ERISA or the Code." Pooled plan providers must also ensure that each participating employer takes all necessary actions for the plan to meet those requirements. The proposal specifies that administrative duties include, but aren't limited to:

- Monitoring compliance with the terms of the plan, IRC and ERISA
- Maintaining accurate plan data, including up-to-date participant and beneficiary information
- Performing and conducting required coverage, top-heavy and nondiscrimination tests, as applicable
- Processing all employee transactions (e.g., investment changes, loans and distributions)
- Satisfying all IRC and ERISA reporting and notice requirements

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- Updating the plan document to reflect IRC and ERISA statutory changes, to the extent that responsibility has been delegated to the plan administrator

Coordination with EPCRS

The proposal's preamble has a separate section about coordination with the IRS Employee Plans Compliance Resolution System (EPCRS). This section notes that a MEP administrator's failure to timely deliver a first notice to an unresponsive participating employer is a significant operational failure that generally may be corrected under the Self Correction Program (SCP). The Voluntary Correction Program (VCP) is available to correct failures after the self-correction period ends. However, once a plan is under audit, the only way to correct the error is through the Audit Closing Agreement Program (Audit CAP), which may involve paying a sanction.

The preamble also explains that if the MEP administrator fails to timely deliver a first notice, but the unresponsive participating employer acts to resolve the failure and all other requirements for correcting the underlying failure are met, then the participating employer failure ceases to exist. In this case, IRS will consider the operational failure to timely deliver the first notice to be corrected.

Prior proposal rescinded

IRS previously proposed regulations to establish a one-bad-apple exception in 2019. However, that proposal predated the enactment of the SECURE Act. To include PEPs in the exception, IRS has rescinded that rule and proposed this new one for PEPs and other MEPs.

Request for comments

IRS and Treasury request comments on all aspects of the proposal, but in particular on the following:

- What, if any, guidance would be helpful to determine whether a MEP is maintained by employers that have a common interest beyond adopting the plan, and how IRS and DOL should coordinate such guidance?
- Under what circumstances, if any, should amounts attributable to an employee's service with an unresponsive participating employer be left in the plan after an employer-initiated spinoff?
- Should IRS provide special rules permitting amounts otherwise subject to mandatory distribution to remain in the MEP, including distributions owed to missing participants?

Related resources

Non-Mercer resource

- Proposed rule for multiple-employer plans (Federal Register, March 28, 2022)

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Mercer Law & Policy resources

- DOL finalizes pooled plan provider registration requirements (Nov. 20, 2020)
- Rules for DC multiple-employer plans eased as DOL seeks input on open MEPs (July 31, 2019)
- IRS proposes relief from ‘one bad apple’ rule for DC multiple-employer plans (July 3, 2019)

Other Mercer resource

- Mercer Wise PEP

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