Must I Complete the Upcoming Mandatory Plan Document Restatement Before Terminating My Plan?

Facts

I currently sponsor a 401(k) plan for my employees. As I start to consider retirement myself and eventual dissolution of the business, I'm compiling a list of all the things I need to do to wind down. One of those to-do items is to terminate the 401(k) plan.

Question

I recently received an email from my TPA, talking about an upcoming requirement to restate my plan document. Is this something that I have to do before I can terminate my plan?

Answer

Let's start with a quick recap before we get into those details. There is an IRS-mandated plan document restatement cycle that starts August 1, 2020 and goes through July 31, 2022. It applies to defined contribution plans such as 401(k) plans that use a plan document that has been pre-approved by the IRS. It is known as "Cycle 3" because it is the third time plans have had to restate under this IRS process. This restatement will incorporate regulatory and legislative changes which occurred between 2010 and 2017. For those looking for more details on the what and why of Cycle 3, we have some handy FAQs here.

So, back to your question of whether you must restate your plan document if you terminate your plan before July 31, 2022. The short answer – which we think you will like – is "no." But, like all good retirement plan topics, the short answer doesn't tell the whole story, so we'll review the various items to consider here as you weigh your decision to restate or not.

When a plan terminates, it is always a requirement that the plan document language be updated to include any legislative or regulatory changes applicable since the last restatement. This is true whether or not you find yourself in the middle of a restatement window. Outside of a restatement cycle, the only option for updating language is via a so-called good faith or interim amendment. DWC prepares these for clients as part of our standard plan termination process. During the restatement window, however, you have two options: good faith amendment or full restatement.

Good Faith Amendments

Let's start with good faith amendments. Between restatement windows, good faith amendments are typically used to update plan language for interim legislative and regulatory changes. We won't bore you with the gory details, but the rule of thumb is that these amendments must usually be adopted within a year or two following the law change. There are some exceptions, but that's the gist.

This allows plan sponsors to maintain compliance without the cost and hassle of a full restatement every time new guidance is released. Because the IRS does not review and approve these interim amendments, service providers draft them in "good faith" to comply with the specified changes until the IRS-approved language is incorporated in a subsequent restatement. A few examples of good faith amendments from the past couple of years include:

- The disability claims procedure amendment, and
- The hardship distribution amendment.

We've added a few new ones this year too, including amendments for the SECURE Act (passed in December 2019) and the CARES Act (passed in March 2020). For a complete list of required restatements and amendments, checkout the details here.

Note, these good faith amendments are different from amendments initiated by plan sponsors to make "discretionary" changes to plan provisions. Want more information on voluntary amendments? We've got you covered here.

Full Plan Document Restatement

When a plan sponsor adopts a full restatement, the current plan document provisions carry forward and include of all the required language associated with the restatement. Since there is no limit on the number of changes that can be included in a restatement, this is also a great time to review plan design more generally and include any voluntary updates at the same time.

Arguably, on the surface, the result is the same - the plan document has been updated to incorporate the required language. If that's the case, why would some plan sponsors choose one method over the other? The answer may just be peace of mind.

Choose Your Own Adventure

While a full plan document restatement is typically more expensive than adoption of good faith amendments, a full restatement allows you to rely on the IRS approval of that language. If you are more cost-driven, you may prefer good faith amendments, accepting the potential risk associated with adopting language that has not been approved by the IRS (when approved language is otherwise available). If you are more risk-conscious, then the peace of mind that comes from knowing you can rely on IRS approval might make it worthwhile to spend a few extra dollars on a full restatement.

There are two quick comments we should add. First is that we are not personally aware of any actual situations in which the IRS took issue with good faith amendments in this context. Second, because of the time it takes the IRS to approve plan documents, there is pretty much always a lag of several years. For example, the Cycle 3 restatements only includes regulatory/legislative changes through January 31, 2017. That means guidance issued after that date must still be addressed via good-faith amendments. Examples include the SECURE and CARES Acts. We know…it all seems a bit convoluted.

Regardless of the method chosen, full restatement or good faith amendment, it is absolutely critical the plan document is updated by the time you terminate your plan. Although the intention may be to terminate the plan during the restatement window, terminated plans can still be selected for random IRS audit. Meaning, if there is a chance the IRS may ask to review the plan's document, you want to be sure you can provide a complete and compliant document to satisfy that request.

For those on the fence about terminating their plans, the prospect of a plan restatement may tip the scales toward termination. We certainly cannot argue with a desire to save a few dollars if it is already the intent to terminate the plan, but it is important to be certain. The reason is something called the successor plan rule, which requires you to wait for a full year after completing a plan termination before you can start a new plan. If a company terminates its plan to avoid the restatement but then has a change of heart within a year, there will be delay before setting up another plan.

If you're debating plan termination because the plan may not be meeting your goals any longer, the restatement is a great opportunity to review design. It's likely that there are opportunities to change provisions to get more bang for your buck, target key employees, or ease administration to make that plan feel less like a hassle and more like an asset. If you want to explore different plan designs or review some custom design illustrations, reach out to DWC and we'll be happy to work with you to make sure your plan works for you!