Published on *The National Law Review* https://natlawreview.com

You Don’t Have To Go Home, But You Can’t Stay Here

Article By:

M. John Burgess

It’s 2024, which means a new batch of provisions from SECURE Act 2.0 have gone into effect. One of the more significant ones is an increase in the “cashout” limit that a qualified plan can impose to kick former employees with small balances out of their plans.

The cashout limit allows a qualified plan to force a distribution of the accrued benefit of a participant whose account balance is below a certain threshold stated in the Internal Revenue Code. You don’t need the participant to make an election or otherwise consent to the distribution; you just have to give them a reasonable period to make an election as to how they want to receive the benefit. If they don’t respond, the plan ships out the benefit. If the value of the forced distribution is over $1,000 and the participant doesn’t elect how to receive the benefit, the distribution must go into an IRA established for the participant – and it isn’t hard for a plan to find a service provider who will be happy to set up those IRAs.

For a while, this limit was $3,500 and was increased to $5,000 by the Taxpayer Relief Act of 1997. The final regulations for this increase became effective October 17, 2000. SECURE Act 2.0 bumps it up to $7,000 as of January 1, 2024. Plans aren’t required to have a force-out provision, but nearly all do, and for good reason.

It’s hard to imagine a scenario where it wouldn’t be smart for a plan to take advantage of the increased limit. Here are the main reasons why:

- The IRS and DOL have made it known to plan sponsors that it’s important for them to do their best to keep track of terminated employees so those participants can ultimately get the benefits they’ve earned. The more participants you can drop, the fewer participants you have to worry about losing.
- Plans with 100 or more participants (generally, it’s 100; the rules are a little more complex than that) with account balances at the start of the plan year must be audited by an independent CPA firm. While I’m one of the first people who will tell you that good auditors provide value and can catch a lot of operational errors before they snowball into bigger problems, they aren’t cheap. Sponsors on the borderline of needing an audit usually want to avoid the cost if they can, so removing more account balances might get the plan under the limit.
- For bigger plans that are more likely to be the target of a class action lawsuit, removing participants can reduce the leverage that a participant class can have, even if the claims

aren't all that strong. Once a class action is filed, it's largely a numbers game.

- If the plan's third-party administrator charges a fee based on the number of participants, reducing the plan's headcount naturally reduces that fee.
- Distributing the balance of a participant who isn't 100% vested allows the non-vested amounts to be moved into the plan's forfeiture account, and those amounts can pay plan expenses, offset contributions, or be reallocated to other employees.
- For ESOPs (sorry, I had to get in something specific to ESOPs), forcing out a participant's balance earlier can help control the plan's repurchase liability, assuming that the value of the stock will increase. It's generally less expensive to buy out the stock earlier. Plus, if shares are forfeited, they can be allocated to other employees, and having enough shares to allocate to current employees can become more of a struggle as an ESOP matures.

Recent guidance extended the required amendment adoption date to December 31, 2026, for many SECURE 2.0 provisions, including this increase to the cashout threshold. Plan sponsors wanting to use the higher threshold may do so while waiting to adopt an amendment. Those inclined to increase their cashout level should discuss the change process with their third-party administrators before taking any action themselves.

Jackson Lewis P.C. © 2024

National Law Review, Volumess XIV, Number 36

Source URL:https://natlawreview.com/article/you-dont-have-go-home-you-cant-stay-here