IN THIS ALERT:

- **SECURE ACT**

The SECURE Act, enacted into law on December 20, 2019, changed a number of retirement plan provisions, but will also have a significant impact on estate planning for those who have saved meaningful amounts for their retirement. The major changes to retirement plans will be discussed in this first part of this two part Alert. The second part will deal with the elimination of the stretch IRA and the new rules taking its place, including a brief discussion of how estate planning documents may need to be changed. Also included will be ideas on how to make up for the reduction in value of retirement benefits for children/grandchildren caused by the elimination of the stretch IRA.

**Major Retirement Plan Changes**

Even though the law has been heralded as a major retirement plan law, almost all of the retirement related changes are fairly minor. The one provision that could prove to be important is the open multiple employer plan, better known as a “MEP.” The concept of a MEP is that a group of plans will band together and by doing so will enjoy lower plan administration costs, lower investment fees in mutual funds investments, reduced fiduciary responsibility and will no longer be burdened with filing annual IRS forms. The SECURE Act removed two major roadblocks which in the past kept small businesses away from joining MEPs. Plan administrators have cast doubts on the ability of a MEP to reduce administrative fees, but it appears the other advantages will prove to be significant. What is not clear is how much flexibility with respect to investments and plan design an employer will have to give up to join a MEP. Some contend that while MEPs may not attract significant numbers of new plans, they are likely to attract a number of existing retirement plans from companies eager to reduce fees, fiduciary liability and some administrative burdens. It is clear that many insurance companies, brokerage houses and associations will set up MEPs.

Other changes include:

- With respect to individuals who attain age 70 ½ after December 31, 2019, the required beginning age for required minimum distributions (RMDs) from retirement plans and IRAs has been moved back from age 70 ½ to age 72. This means that **people who did not attain age 70 ½ before December 31, 2019, will be able to postpone taking out RMDs for a year and a half.** Congress recognized that life expectancy has increased over the last 60 years, but of course life expectancy has increased more than 1 ½ years during those years! While this is a welcome change, moving back the required beginning date for taking out distributions from an IRA or a retirement plan by only a year and six months is not all that exciting.

- Starting this year, **plan participants can take a penalty-free distribution from a defined contribution plan account (such as a profit sharing plan or a 401(k) plan) of up to $5,000 within one year after birth or legal adoption of a child,** with an option to repay under certain circumstances. It is not clear whether this is a mandatory provision which a plan must adopt or
whether it is up to the employer to decide to allow this type of withdrawal. This new provision takes away the ten percent early withdrawal penalty for this type of withdrawal, but the distribution will still be taxable.

- For plan years beginning after December 31, 2019, the annual safe harbor notice for the 401(k) nonelective safe harbor (this is the 401(k) safe harbor that requires a 3% employer contribution) is eliminated. By making a 3% nonelective 401(k) safe harbor contribution, the IRS 401(k) discrimination rules are not applicable to the plan. The notice is still required for a safe harbor matching contribution.

- Before the SECURE Act there were stricter rules as to when a plan had to adopt a 401(k) safe harbor (as a general rule, notice that the plan was or might be safe harbored had to be given before the beginning of the plan year). For plan years beginning after December 31, 2019, the SECURE Act allows the employer to safe harbor a 401(k) plan before the 30th day before the close of the plan year. This new provision will allow an employer to determine that if the plan was going to fail the 401(k) testing, then up to 30 days before the end of the plan year it could adopt the 3% nonelective safe harbor and retroactively have the safe harbor rules apply to the beginning of the year. This would allow highly compensated employees to make the maximum 401(k) contributions in that year regardless of the contributions made by the non-highly compensated employees. Employers could monitor the employee contributions going in to the 401(k) during the year and adopt the safe harbor provision if needed to allow the highly compensated employees to keep their contributions. Even up until the end of the following plan year, the company can retroactively adopt the safe harbor provisions - but the 3% safe harbor contribution must be increased to 4%.

- For plan years beginning after December 31, 2020, the SECURE Act will allow part-time employees who have worked 500 hours over a consecutive three year period to make 401(k) contributions. No employer contributions would be required to be made for these individuals and they could be excluded from IRS discrimination tests. Plans could still require part-time employees to attain age 21. Years starting January 1, 2021 will be used to determine if an employee has worked 500 hours per year over the three consecutive year period. This means that the first time part-time employees must be allowed to contribute to a 401(k) plan under this provision is the 2024 plan year. Plan administrators are going to need a lot of guidance from IRS to figure out how to make this provision work – for instance, what happens when employees go back and forth between full and part-time status?

- The SECURE Act allows a business to adopt a retirement plan up until the due date (including extensions) of the tax return for the taxable year and treat the plan as if it had been adopted on the last day of the taxable year. As long as a retirement plan is adopted on the last day of a taxable year, it can have an effective date retroactive to the beginning of that year. This provision is effective for tax years beginning after December 31, 2019. Prior to this new provision, a retirement plan had to be adopted by the last day of the taxable year – thus, this provision will give companies more time to decide to adopt a plan. This provision is likely to be used by a smaller company which ends up with more profit than expected in a taxable year, particularly if the profit is determined after the close of the tax year.

- Other provisions include:
  - An increase in the automatic 401(k) contributions limit from 10% to 15%. Companies are already requesting transition relief and additional guidance from IRS with respect to this provision due to its effective date of plan years beginning after December 31, 2019.
- Defined contribution plans (profit sharing plans, 401(k) plans) will be required to give participants an annual estimate of the monthly income their account balance would purchase if the participant selected an annuity – even if the plan does not provide for an annuity option. Both a joint and survivor annuity (an annuity which will pay out during the lifetime of the participant and then to surviving spouse) and a single life annuity for only the participant must be illustrated. The Department of Labor has to issue a model disclosure and the assumptions that the plans must use to come up with the annuity values within a year of enactment. This provision is effective 12 months after the release of the DOL guidance. If a plan provides the DOL model disclosure and stays within the assumptions DOL requires and the guidance it has provided, then there will be no liability under ERISA. The SECURE Act does not provide a minimum account balance for which the disclosure is not required. The purpose of this provision is to encourage plan participants to consider purchasing an annuity with their account balances. This will add an administrative burden to plan administrators.

- The credit for a small employer plan startup costs is increased beginning after December 31, 2019. There is also a new small credit of up to $500 per year for up to three years for new 401(k) and SIMPLE IRA plans that have automatic enrollment (or existing plans that add the auto enrollment feature). This credit is in addition to the credit for plan start-up expenses.

- Effective immediately, there is a new safe harbor intended to provide relief from the fiduciary liability involved in the selection of an annuity provider for participants who elect an annuity payout option. At least from the viewpoint of trial attorneys this safe harbor may not prove as difficult to get around as Congress would have hoped. On the other hand, it is certainly better than nothing. Many plans will want to wait for guidance from IRS before trying to fit within the safe harbor. If a company’s retirement plan does not provide for an annuity option for payment of retirement benefits, then this provision is not relevant.

- Section 529 qualified tuition program is expanded to cover costs associated with registered apprenticeships and qualified education loan repayments. This is an important provision for many SBLC members and one which they supported while the legislation was developed. This may prove to be one of the more important sections of the SECURE Act.

- In-service distributions from defined benefit plans can be made for participants at age 59 ½ while they are still working (reduced from age 62). This is effective for plan years beginning after December 31, 2019. This does not appear to be a mandatory provision but guidance is required from IRS.

- Significant increases are made to penalties for failing to file Form 5500 and other notices. Because these penalties have increased so dramatically, it will be more important for companies to ensure that the required IRS forms are filed on time.

- The Act provides that if a plan is in operational compliance it does not have to be amended for the SECURE provisions until the last day of the 2022 plan year or a later date if Treasury so provides.
UPCOMING EVENTS

2020 Annual Meeting:  

For more info or to get a registration form, contact Kathy Glenn at kglenn@paleyrothman.com.