Client Alert

March 2020

The SECURE ACT Passage Means Significant Changes to Individual Retirement Planning and Qualified Retirement Plans

On December 20, 2019, the President signed a broad-based spending bill that included the Setting Every Community Up for Retirement Enhancement Act, known as the SECURE Act (the "Act"). The Act is widely regarded as one of the most (if not the most) significant change to the U.S. retirement benefit system in at least two decades. The Act contains provisions relating to individuals and retirement plans, as well as provisions relating to the timely adoption of certain required amendments, and penalties for non-compliance. As a result, businesses and individuals should familiarize themselves with the Act's provisions, the most significant of which are discussed below.

Individuals

Age-Based Changes

The Act removed the upper age limit on when contributions may be made to individual retirement accounts ("IRAs"), effective for contributions made for taxable years beginning after December 31, 2019.

The Act also raised the age by which plan participants/IRA owners must begin to take required minimum distributions ("RMDs") from age 70½ to age 72.

Changes to Post-Death RMD Rules

The Act no longer permits distributions from certain qualified retirement plans and IRAs to be paid out over the life or life expectancy of designated beneficiaries, except for a new subset of designated beneficiaries known as "eligible designated beneficiaries" or "EDBs." An EDB can be any of the following five designated beneficiaries: (1) the surviving spouse; (2) a minor child; (3) a chronically ill individual; (4) a disabled individual; or (5) an individual who is not more than ten years (10) younger than the participant/IRA owner.

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EDBs can take distributions over their life or life expectancy, but any remaining account balance upon their death must be fully paid out within ten (10) years of the EDB's death (or within ten (10) years after a minor child EDB reaches the age of majority). Designated beneficiaries who are not EDBs must take distributions within ten (10) years following the death of the participant/IRA owner. Finally, as under prior law, distributions to a beneficiary who is not a designated beneficiary (e.g., an estate) must be fully paid out over five (5) years following the death of the participant/IRA owner. These changes apply whether the participant/IRA owner dies before, on, or after his or her required beginning date. The Act effectively eliminates the stretch IRA for non-EDBs.

Targeted Changes

The Act includes several provisions that generally only apply to a small, select group of the general public:

(1) the Act modifies tax-favored 529 plans (a college savings plan) to allow these funds to be used for expenses paid for registered apprenticeship programs as well as expenses used to pay down the interest or principal (up to $10,000) on qualified education loans;

(2) the Act modifies the "kiddie tax," which taxes minor children on their unearned income at their parent's tax rate (assuming the parent's tax rate is higher than the child's). This change is effective for tax years beginning after December 31, 2019, but taxpayers can elect to have it apply retroactively to tax years which began in 2018, 2019 or both;

(3) the Act allows penalty-free withdrawals from "applicable eligible retirement plans" of up to $5,000 to pay for expenses related to a qualified birth or adoption;

(4) the Act allows taxable fellowship/stipend income to be used as a basis for IRA contributions; and

(5) the Act permits "difficulty of care" payments to be used to increase the limit for non-deductible IRA contributions and/or to be used as a basis of contributions to defined contribution plans.

Plans

401(k) Plans

The Act made changes to 401(k) safe harbor plans: (1) the safe harbor notice requirement has been eliminated for nonelective safe harbor plans (but retained for matching contribution 401(k) safe harbor plans); (2) a plan can be amended to become a nonelective 401(k) safe harbor plan at

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any time before 30 days prior to the end of the plan year; and (3) a plan can be amended after 30 days prior to the end of the plan year if the plan provides for 4% nonelective contributions so long as the plan is amended no later than the last day of the following plan year.

The Act raises the maximum default contribution rate to 15% of eligible compensation for 401(k) automatic enrollment safe harbor plans.

Finally, the Act requires plan sponsors to expand the eligibility to make employee elective deferrals to a company's 401(k) plan for certain part-time employees who are over age 21 and have worked at least 500 hours a year for that employer for at least three (3) consecutive years. Note that such part-time employees are not required to be offered employer contributions and may also be excluded from non-discrimination testing.

With all of these changes, it is worthwhile to note that the general rule that requires 401(k) plans to provide employees with the opportunity to make or change an election to make elective deferrals at least once each plan year has been retained for all types of 401(k) safe harbor plans.

Pooled Multiple Employer Plans

The Act establishes a new type of multiple employer plan – the pooled employer plan, a plan offered by unrelated employers to their respective companies' employees. The pooled employer plan utilizes economies of scale to incentivize smaller employers to expand coverage for their employees. The Act also eliminated the "one bad apple" rule (disqualifying an entire multiple employer plan if one employer participating in the pooled plan fails to satisfy the IRS's plan qualification rules). This change is effective for plan years beginning after December 31, 2020.

Prudent Man Requirement

The Act added a new safe harbor for fiduciaries who select annuity providers to provide plan benefits and the annuity provider defaults on its obligations. The fiduciary must: (1) engage in an "objective, thorough, and analytical" search for sellers of guaranteed retirement income contracts; (2) consider the financial capability of the provider and consider the cost of the contract; and (3) conclude that the annuity provider is financially solvent and the cost is reasonable. A best practice to meet this safe harbor is to obtain written representations from the insurer to satisfy points 2 and 3.

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Miscellaneous Plan-Related Changes

The Act also made a number of significant changes to qualified retirement plans:

(1) if a lifetime income investment is no longer permitted as an investment option (e.g., in defined contribution plans), the participant can rollover the investment to another eligible retirement plan or receive a distribution;

(2) the Act allows small employers to claim a $500 tax credit per year for up to 3 years for adding an automatic enrollment feature to a 401(k) or IRA plan, and the Act also increases a separate tax credit available to cover start-up costs for small businesses that establish new 401(k), pension, or other eligible plans;

(3) benefit statements provided to defined contribution participants must include a "lifetime income disclosure" at least once a year;

(4) similar defined contribution plans maintained by unrelated employers may file a single consolidated Form 5500 (subject to requirements);

(5) plan loans can no longer be made through the use of credit card processing;

(6) participants in closed or frozen defined benefit pension plans can continue to accrue benefits, and the Act provides relief from the nondiscrimination, minimum coverage and minimum participation rules for such plans;

(7) for terminated 403(b) plans, the plan administrator/custodian may distribute the custodial account in kind to the participant/beneficiary, provided such account is maintained on a tax-deferred basis until paid out; and

(8) new pension or profit-sharing plans must be adopted by the due date of the plan sponsor's tax return (including extensions) to be treated as maintained for a tax year.

Sponsors of existing plans will need to adopt required plan amendments to implement the Act's provisions by the last day of the first plan year beginning after January 1, 2022 (January 1, 2024 for governmental plans and collectively bargained plans).

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Penalties

The Act increases penalties for failing to file: (1) income tax returns; (2) Form 5500; (3) Form 8955-SSA; and (4) certain other required notifications (e.g., a required withholding notice).

Other Changes

Changes in the Spending Bill

Apart from the changes made by the Act, the spending bill lowered the age for in-service distributions from defined benefit and governmental plans to age 59½ (from 62). The spending bill also repealed (1) the "Cadillac tax" (the excise tax on high-cost employer-sponsored health plans); (2) the health insurance providers' tax; and (3) the excise tax on the price of medical devices sold in the United States.

Conclusion

The Act made sweeping changes to the retirement benefit landscape. While certain changes will impact virtually all plan participants and plan sponsors, some of its provisions may be more benign as they affect only certain targeted groups. Businesses and individuals should be aware that some provisions are already effective, some provisions can be applied retroactively, and some provisions will only become effective in the future. The Act eliminated certain popular planning techniques, but may have opened doors to other planning opportunities. As this new law can have far-reaching effects on qualified plans and retirement distribution planning, we remain available to help guide you in complying with these new rules.

Please contact the Olshan attorney with whom you regularly work or one of the attorneys listed below if you would like to discuss further or if you have questions.

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