The SECURE Act – Substantial Changes for Retirement Plans and IRAs

By Peter Alwardt, CPA

The Setting Every Community Up for Retirement Enhancement Act of 2019 ("SECURE" or the "Act") was signed into law by President Trump on December 20, 2019. The Act makes substantial changes to both qualified retirement plans and IRAs in operation and includes substantial increases in penalties for failure to file information returns related to such plans. Many of these provisions go into effect in 2020, so retirement plan sponsors and IRA account holders need to be aware of these changes and their impact on their particular situation.

Changes Affecting Retirement Plans

401(k) Plan Changes

Safe Harbor Plans – Effective for plan years beginning after December 31, 2019, the Act eliminates the requirement for the plan sponsor to give notice to plan participants before the beginning of the plan year in the case where the plan sponsor is making qualified non-elective contributions of 3% to all eligible participants. For plan sponsors making safe harbor matching contributions, the requirement to give participants advance notice continues to apply.

Additionally, plan sponsors are permitted to amend the plan to a non-elective safe harbor plan with 3% qualified non-elective contributions (not matching safe harbor contributions) at any time up to 30 days prior to the close of the plan year. The amendment may also be made within 30 days of the end of the plan year, but, in that case, a 4% qualified non-elective contribution is required in place of the 3% contribution.

The Act also raised the automatic escalation cap for qualified automatic contribution arrangements from 10% to 15%.

Changes to All 401(k) Plans

In an effort to encourage coverage to permanent part-time employees, 401(k) plans (except for those covering union employees) will be required to have dual-eligibility provisions under which an employee will be required to complete either 1) one year of service and 1,000 hours or 2) three years of service in which the employee has worked at least 500 hours. In order to mitigate the potential problems in passing annual nondiscrimination testing, the plan sponsor may elect to exclude those participants meeting the second requirement from the testing. This change is effective for plan years beginning after December 31, 2020.

Changes to All Defined Contribution Plans

Penalty-free Withdrawal for Birth or Adoption of a Child

Plan participants may take a distribution of up to $5,000 as a penalty-free early withdrawal from their retirement plan to help cover expenses related to the adoption or birth of a child. The distribution may be repaid at a later date if the participant so chooses. This rule is effective for distributions after December 31, 2019.

Waiver of Penalties for Qualified Disaster Distributions

Effective for distributions after December 31, 2019, the Act waives penalties for distributions of up to $100,000 from plans related to a qualified disaster as defined under prior IRS guidance.

Lifetime Income Provisions

The Act adds three provisions related to the encouragement of lifetime income options (also known as annuity payments) in defined contribution plans. First, the Act will require that, at least once every 12 months, participant statements include an illustration of the annuity equivalent of the plan participant's account using assumptions to be developed by the U.S. Department of Labor ("DOL"). This provision is effective for participant statements distributed more than 12 months after the DOL has drafted and published model disclosures and the related assumptions for calculating the annuity amount.

The second provision is a safe harbor related to a plan fiduciary's selection of an annuity provider to provide guaranteed lifetime income under a plan. Specifically, plan fiduciaries may rely on the representations of the insurance company with regard to its ability to fulfill its obligations under the contract and may also rely on the insurer's status under state insurance laws. This provision is effective with the Act's enactment into law – December 20, 2019.

The third provision will impact plan sponsors that no longer want to offer an existing lifetime income option under their plan. It allows plans to make a direct rollover to an IRA or another retirement plan of a lifetime income (annuity) investment starting 90 days prior to the date after which such investments will no longer be available under the plan. This provision is effective for plan years beginning after December 31, 2019.

Open Multiple Employer Plans ("MEPs")

Effective for plan years beginning after December 31, 2020, the Act expands the ability of employers to join together and create defined contribution plans that are more cost-effective through economies of scale by eliminating the requirement that employers participating in a MEP have an organizational relationship or an employment-based relationship. It also eliminates the IRS's "one bad apple" rule that stated if one participating employer violated the plan tax qualification rules, it could jeopardize the tax qualified status of the plan for all participating employers. An open MEP arrangement as contemplated by the Act will use a designated pooled plan provider, who is the named plan fiduciary and plan administrator and who must be registered with DOL or IRS and is subject to an ERISA bond of $1 million covering all individuals handling plans assets of the MEP.

Changes Affecting 403(b) Plans

A not-for-profit plan sponsor that terminates a 403(b) plan with investments held in a custodial account (i.e., registered mutual funds rather than annuity contracts) may distribute those accounts in-kind to each participant or beneficiary under the plan and the amounts distributed will receive IRC Sec. 403(b) treatment until the amounts are actually paid to the participant or beneficiary. The Act requires the Treasury Department to issue guidance within six months of the date of enactment allowing this provision under the regulations and that guidance, once published, may be applied retroactively to plan years beginning after December 31, 2008.

Changes Affecting Defined Benefit Plans

The Act modifies the nondiscrimination testing rules for frozen defined benefit plans under what is known as a "soft freeze," in which a plan does not allow new participants, but existing participants continue to accrue benefits under the plan. Due to workforce attrition over time, these plans typically do not cover a sufficient percentage of the employee population to pass nondiscrimination testing. The Act liberalizes the methods that can be used to pass the nondiscrimination testing making it viable to continue to maintain them for the covered employees. These rules are effective with the Act's enactment on December 20, 2019, but employers may elect to apply them retroactively to plan years beginning after December 31, 2013.

Changes Affecting All Plans

Plan Distributions

Increase in the Age for Required Distributions – Under prior law, plan participants are, generally, required to begin taking required minimum distributions annually beginning with the year they attain the age of 70½. Effective for required minimum distributions after December 31, 2019 to plan participants who will attain age 70½ after December 31, 2019, the age to begin required minimum distributions is increased from 70½ to age 72. Participants who attained age 70½ prior to December 31, 2019 will be required to continue taking their minimum required distributions under the old rules.

Acceleration of Distributions After Participant's Death – Under prior law, plan distributions to non-spouse beneficiaries could, generally, be "stretched" over the life expectancy of the decedent's children or grandchildren, thus minimizing the amounts that needed to be distributed annually. Effective for distributions with respect to participants that die after December 31, 2019, the entire account balance of the participant will have to be distributed to non-spouse beneficiaries by the end of the tenth year following the year that the participant died. This rule applies regardless of whether the participant dies before or after their required beginning date for required minimum distributions.

The Act provides for limited exceptions to this requirement in the case of a designated beneficiary who is a minor child, is chronically ill or disabled, or is not more than ten years younger than the participant.

Additional Time to Adopt a New Plan

Under prior law, tax qualified retirement plans were required to be adopted (executed) by December 31 of the year in which they were to be effective. This rule did not apply to 401(k) provisions, which are required to be adopted before participant salary deferrals can commence under a plan. The Act now modifies this rule to allow all types of qualified plans (except for 401(k) provisions) to be adopted by the due date of the plan sponsor's tax return, including any extensions and be effective for the prior tax year. This gives plan sponsors an alternative to adopting a Simplified Employee Pension ("SEP") plan, which until this change was the only type of plan that could be adopted after the end of the plan sponsor's taxable year and still be effective for the prior year. This provision is effective to plans adopted for tax years beginning after December 31, 2019.

Increased Small Plan Start-Up Tax Credit

Under prior law, employers with no more than 100 employees and with at least one non-highly compensated employee that did not previously have a retirement plan and started a new retirement plan were eligible for a non-refundable tax credit of up to $500 annually for the first three years to offset the start-up costs of the new plan. The Act provides that the annual credit is now calculated as $250 multiplied by the number of non-highly compensated employees eligible to participate in the plan capped at the lesser of $5,000 or 50% of the plan's start-up costs (but in any case not less than $500). In addition, if the new plan automatically enrolls employees into the plan, there is an additional credit annually of $500. This change is effective January 1, 2020.

Increased Penalties for Failure to File Information Returns and Registration Filings

The Act substantially increase penalties for failure to file certain plan-related returns. The changes are as follows:

- The penalty for filing a late Form 5500 is increased from $25 per day for each day the return is late up to a maximum of $15,000 annually to $250 per day with a maximum annual penalty of $150,000.
- The penalty for failing to file a registration statement (IRS Form 8955-SSA) to report terminated participants with a vested benefit due to them will increase from $1 per participant per day to $10 per participant per day with the maximum annual penalty increasing from $5,000 to $50,000.
- The penalty for failure to provide a notification of change of certain information such as the plan name; the plan sponsor or plan administrator; or a merger, consolidation, or division of a plan will increase from $1 per day to $10 per day and the maximum penalty will increase from $1,000 to $10,000.
- The penalty for failing to provide a required withholding notice to a plan participant receiving a distribution from a plan will increase from $10 per failure to $100 per failure with the maximum penalty increasing from $5,000 to $50,000.

The penalty increases apply for filings, registrations, and notifications that are required after December 31, 2019.

Changes Affecting IRAs

Elimination of Age Requirement for Contributions

The Act eliminates the age limit of 70½ for making deductible contributions to a traditional IRA. The requirements regarding income, phase out of the contribution's deductibility and other rules still apply to such contributions. This change is effective for tax years beginning after December 31, 2019.

Increase in the Age for Required Distributions

Under prior law, owners of traditional IRA accounts (not Roth IRAs) are required to begin taking required minimum distributions annually beginning with the year they attain the age of 70 ½ . Effective for required minimum distributions after December 31, 2019 to account holders who will attain age 70 ½ after December 31, 2019, the age to begin required minimum distributions is increased from 70 ½ to age 72. Participants who attained age 70 ½ prior to December 31, 2019 will be required to continue taking their minimum under the old rules.

Acceleration of Distributions After Account Holder's Death

Under prior law, distributions to non-spouse beneficiaries after the account owner's death could, generally, be "stretched" over the life expectancy of the decedent's children or grandchildren, thus minimizing the amounts that needed to be distributed annually. Effective for distributions with respect to account holders that die after December 31, 2019, the entire account balance of the account holder will have to be distributed to non-spouse beneficiaries by the end of the tenth year following the year the account holder died. This rule applies regardless of whether the account holder dies before or after their required beginning date for required minimum distributions.

The Act provides for limited exceptions to this requirement in the case of a designated beneficiary who is a minor child, is chronically ill or disabled, or is not more than ten years younger than the participant.

Graduate Student IRA Contributions

Effective for taxable years beginning after December 31, 2019, the Act provides that taxable graduate or post-doctoral fellowships and stipends received by graduate students may be treated as compensation for purposes of making contributions to an IRA account.

Conclusion

The SECURE Act makes substantial changes to both retirement plans and IRAs that affect both the operation of the plans and the planning that has been done around the assets held in the accounts. Both plan sponsors and participants/account holders will want to understand these changes and modify their plans and related planning accordingly. Further, plan sponsors that have been lax regarding compliance with filing deadlines related to qualified retirement plans should take notice of the increased penalties for late filings or failure to provide notices as these provisions are meant to raise revenue for the government to offset the costs of the Act. Recent experience indicates that both IRS and DOL will be quickly assessing these penalties and less willing to grant relief without a valid reason for the failure.

Frye Financial Center

A PLACE WHERE YOU CAN PLAN AND BUILD YOUR FUTURE

Frye Financial Center | 20900 West Dixie Highway | Aventura FL 33180 | 305.931.3200
www.fryefinancial.com