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Year-End Spending Bill includes the SECURE Act and other Retirement Plan Changes

By *John Lucas*

With the passage of the 2020 federal government spending bill less than a week before Christmas, Congress has gifted us with the most significant piece of retirement legislation in over a decade. This newly enacted legislation incorporates the Setting Every Community Up for Retirement Enhancement Act (SECURE Act) that was overwhelmingly passed by the House of Representatives earlier this year but never considered by the Senate. The spending bill even has a few additional retirement related tidbits that were not part of the SECURE Act.

Here are some of the key changes:

Frozen Defined Benefit Plan Nondiscrimination Testing

Currently- Defined benefit plans that were frozen to new hires in the past and operate with a grandfathered group of employees continuing to accrue benefits have ultimately run into problems trying to pass nondiscrimination or minimum participation requirements as the group of benefiting employees became smaller and normally higher paid. This problem for frozen defined benefit plans has been around for a while and the IRS has been providing stop-gap measures to deal with it every year.

Effective as of the date of enactment of this legislation and available going back to 2013 – plans may permit the grandfathered group of employees to continue to accrue benefits without running afoul of nondiscrimination or minimum participation rules so long as the plan is not modified in a discriminatory manner after the plan is closed to new hires. This special nondiscrimination testing relief also extends to:

- defined benefit plans that close certain plan features to new hires,
- defined contribution plans that provide make-up contributions to participants who had benefits in a defined benefit plan that were frozen.

Increasing the 10% Limit on Safe Harbor Auto Escalation

Currently – a safe harbor 401(k) Plan with automatic enrollment provisions cannot automatically enroll or escalate a participant's contribution rate above 10%.

Effective for Plan Years beginning after Dec. 31, 2019 – the 10% cap would remain in place in the year the participant is enrolled but the rate can increase to 15% in a subsequent year.

Simplifying the Rules for Safe Harbor Nonelective 401(k) Plans

Currently – All safe harbor plans must provide an annual notice prior to the beginning of the year that provides plan details and notifies employees of their rights under the plan. Also any plan sponsors that want to consider implementing a safe harbor plan generally must adopt the safe harbor plan provisions prior to the beginning of the plan year.

Effective for Plan Years beginning after Dec. 31, 2019 – the notice requirement for plans that satisfy the safe harbor through a nonelective contribution has been eliminated. Also sponsors can amend their plan to become a nonelective safe harbor 401(k) plan any time up until 30 days prior to year end. The safe harbor election can even be made as late as the end of the next year if the plan sponsor provides for at least a 4% nonelective contribution.

Open Multiple Employer Plans (Open MEPs)

Currently – Multiple employer plans (MEPs) are legal and actually quite common, but a couple of limitations have stunted the development of a concept called open

MEPs. An open MEP is a situation where the employers within the MEP are not tied together through a trade association or some common business relationship. In 2012 the DOL issued an Advisory Opinion provided that a MEP made up of unrelated employers that did not have "common nexus" must operate as a separate plan for each of these unrelated employers and not as a single common plan. This advisory opinion took away much of the perceived advantages of operating an open MEP. Additionally, the IRS has followed a policy that provides if one employer within the MEP makes a mistake, that the error can impact the qualified status of the entire plan; this is known as the "one bad apple" rule, this policy is clearly a negative selling point for any plan sponsor that might consider signing up to participate in a MEP.

Effective for Plan Years beginning after Dec. 31, 2020 – the "common nexus" requirement and the "one bad apple" rule are eliminated. The new open MEP rules provide for a designated "pooled plan provider" that would operate as the MEPs named fiduciary and the ERISA 3(16) plan administrator. The open MEP will be required to file a 5500 with aggregate account balances attributable to each employer. These changes are expected to create a market for pooled plans that will offer efficient retirement plan solutions to smaller plan sponsors.

Required Minimum Distribution Age Now 72

Currently – Required Minimum Distribution from a qualified plan or IRA must begin in the year the participant turns 70 ½.

Effective for Distributions after 2019, with respect to individuals who attain 70 ½ after 2019. – This is a simple change to age 72 for computation purposes, but note the effective date means that if the participant is already subject to RMD rules in 2019 they remain subject to RMDs for 2020 even though the person may not be 72 yet. Also plan sponsors should be aware that distributions made in 2020 to someone that will turn 70 ½ in 2020 will not be subject to RMD rules and therefore would be eligible for rollover and subject to the mandatory 20% withholding rules.

Increase Retirement Savings Access to Long-Term Part-Time Workers

Currently- Plans can exclude employees that do not meet the 1,000 hours of service requirement

Effective for Plan Years beginning after Dec. 31, 2020 – Plans will need to be amended to permit long-term part-time employee who work at least 500 hours over a 3 year period to enter the plan for the purpose of making retirement savings contributions. The employer may elect to exclude these employees from employer contributions, nondiscrimination and top heavy testing.

Stretch IRAs are Eliminated

Currently- If Retirement plan or IRA proceeds are passed upon death to a non-spouse beneficiary; the beneficiary can set up an inherited IRA and "stretch" out payments based upon the beneficiary's life expectancy. Depending upon the age of the beneficiary and the size of the IRA this strategy potentially provided significant tax advantages.

Effective for distributions that occur as a result of deaths after 2019 – Distributions from the IRA or plan are generally going to need to be made within 10 years. There are exceptions if the beneficiary is (1) the surviving spouse, (2) disabled, (3) chronically ill, (4) not more than 10 years younger than the IRA owner or plan participant, or (5) for a child that has not reached the age of majority, the ten year rule would be delayed until the child became of age.

Increased Penalties for Failure to File Retirement Plan Returns and Other Notices

Current Penalty Structure:

Failure to file Form 5500	$25 per day maximum of $15,000
Failure to report participant on Form 8955-SSA	$1 per participant, per day maximum of $5,000

Current Penalty Structure (Continued):

Failure to provide Special Tax Notice	$10 per failure up to a maximum of $5,000

New penalty structure:

Failure to file Form 5500	$250 per day maximum of $150,000
Failure to report participant on Form 8955-SSA	$10 per participant, per day maximum of $50,000
Failure to provide Special Tax Notice	$100 per failure up to a maximum of $50,000

Other Retirement Plan Changes Effective for Years Beginning After December 31, 2019

- Phased retirement changes - defined Benefit Plans can be amended to provide voluntary in-service distributions begin at age 59 ½, down from the current age 62 requirement.
- Start-up credits – the cap on tax credits that small employers (up to 100 employees) can get for starting up a new retirement plan has gone up from $500 to $5,000.
- Auto-Enroll credits for small employers – small employers can get an additional $500 tax credit for adopting an automatic enrollment provision.
- More time to adopt a plan – currently a qualified plan must be adopted by the end of the employer's tax year to be effective for that year. The new rule will permit a plan to be adopted as late as the due date of the employer's tax return for the year.
- Plan annuity provisions – in recognition that defined contribution plans typically do not offer lifetime income streams two changes have been added to encourage in-plan annuity options.
    - A fiduciary safe harbor standard that if followed, would protect plan sponsors from potential liability relating to the selection of an annuity provider.
    - Plans may permit tax-advantaged portability of lifetime income annuity options from one plan to another.
- 403(b) changes include providing a mechanism for the termination of a 403(b) custodial account and clarification that non-qualified church controlled organizations (e.g. hospitals and schools) can participate in Section 403(b)(9) retirement income accounts.
- Penalty free distribution for birth or adoption expenses – up to $5,000 could be distributed from a defined contribution or 403(b) plan to cover costs relating to birth or adoption of a child.
- Special tax penalty relief and income tax treatment for distributions for qualified disaster distributions from qualified plans up to $100,000. Additionally, plan sponsors can permit the $50,000 participant loan limit to be increased to $100,000 with increased repayment periods for participants that suffered losses in a qualified disaster area.

Other Changes with a Delayed Effective Date

- Lifetime income disclosure – this provision will require a defined contribution plan to provide all participants with an annual statement that discloses the projected lifetime income stream equivalent of the participant's account balance. This requirement will become effective for benefit statements furnished one year after applicable DOL guidance has been issued that will be necessary to provide the prescribed assumptions and explanations that will be used to create this disclosure.

- Combining 5500 – IRS and DOL have been directed to permit a consolidation of Form 5500 reporting for similar plans. Defined contribution plans with the same trustee, same named fiduciary and same plan administrator using the same plan year and same plan investments may be combined into one 5500 filing. This is scheduled to begin no later than January 1, 2022, for 2021 calendar plan year filings.

What to Do Now

Obviously the SECURE Act is bringing a lot of changes to retirement plans. Many of the operational aspects to this new retirement legislation will need to be implemented immediately, in particular tax withholding related items that will change in 2020 will necessitate plan sponsors and their recordkeepers act immediately to review tax withholding and distribution processes. Plans do have until the end of the 2022 plan year to adopt conforming amendments to their documents. The amendment deadline is the 2024 plan year for governmental plans.

If you have any questions about the SECURE Act and this new retirement plan legislation we encourage you to contact the Findley consultant you normally work with, or contact John Lucas at *615.665.5329* or *John.Lucas@findley.com*.