Setting Every Community Up for Retirement Enhancement Act (SECURE Act)

On December 20, 2019 the President signed the Setting Every Community Up for Retirement Enhancement Act (SECURE Act; the Act), which is part of the Further Consolidated Appropriations Act, 2020 (P.L. 116-94). The Act refers to as Expanding and Preserving Retirement Savings.

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The SECURE Act was enacted to expand the opportunities for individuals to increase their savings and make administrative simplifications to the retirement system. Specifically, among its changes, it modifies the requirements for multiple employer plans to make it easier for small businesses to offer such plans to their employees by allowing otherwise completely unrelated employers to join in the same plan; increases the age after which required minimum distributions ("RMD") from certain retirement accounts must begin to 72; makes it easier for long-term, part-time employees to participate in elective deferrals; allows consolidated filings of Forms 5500 for similar plans; and allows penalty-free distributions from qualified retirement plans and IRAs for births and adoptions.

SECURE Act provisions affecting plan sponsors

Here is a look at some of the more important elements of the SECURE Act that have an impact on employer-sponsors of retirement plans. The changes in the law apply to both large employers and small employers, but some of the changes are especially beneficial to small employers. However, not all of the changes are favorable, and there may be steps you could take to minimize their impact. Please give me a call if you would like to discuss these matters.

It is easier for unrelated employers to band together to create a single retirement plan. A multiple employer plan (MEP) is a single plan maintained by two or more unrelated employers. Starting in 2021, the new rules reduce the barriers to creating and maintaining MEPs, which will help increase opportunities for small employers to band together to obtain more favorable investment results, while allowing for more efficient and less expensive management services.

New small employer automatic plan enrollment credit. Automatic enrollment is shown to increase employee participation and retirement savings. Starting in 2020, the new rules create a new tax credit of up to $500 per year to employers to defray start-up costs for new 401(k) plans and SIMPLE IRA plans that include automatic enrollment. The credit is in addition to an existing plan start-up credit, and is available for three years. The new credit is also available to employers who convert an existing plan to a plan with an automatic enrollment design.

Increased credit for small employer pension plan start-up costs. The new rules increase the credit for plan start-up costs to make it more affordable for small businesses to set up retirement plans. Starting in 2020, the credit is increased by changing the calculation of the flat dollar amount limit on the credit to the greater of (1) $500, or (2) the lesser of: (a) $250 multiplied by the number of non-highly compensated employees of the eligible employer who are eligible to participate in the plan, or (b) $5,000. The credit applies for up to three years.

Expand retirement savings by increasing the auto enrollment safe harbor cap. An annual nondiscrimination test called the actual deferral percentage (ADP) test applies to elective deferrals under a 401(k) plan. The ADP test is deemed to be satisfied if a 401(k) plan includes certain minimum matching or non-elective contributions under either of two safe harbor plan designs and meets certain other requirements. One of the safe harbor plans is an automatic enrollment safe harbor plan.

Starting in 2020, the new rules increase the cap on the default rate under an automatic enrollment safe harbor plan from 10% to 15%, but only for years after the participant's first deemed election year. For the participant's first deemed election year, the cap on the default rate is 10%.

Allow long-term part-time employees to participate in 401(k) plans. Currently, employers are generally allowed to exclude part-time employees (i.e., employees who work less than 1,000 hours per year) when providing certain types of retirement plans—like a 401(k) plan—to their employees. As women are more likely than men to work part-time, these rules can be especially harmful for women in preparing for retirement.

However, starting in 2021, the new rules will require most employers maintaining a 401(k) plan to have a dual eligibility requirement under which an employee must complete either a one-year-of-service requirement (with the 1,000-hour rule), or three consecutive years of service where the employee completes at least 500 hours of service per year. For employees who are eligible solely by reason of the new 500-hour rule, the employer will be allowed to exclude those employees from testing under the nondiscrimination and coverage rules, and from the application of the top-heavy rules.

Looser notice requirements and amendment timing rules to facilitate adoption of nonelective contribution 401(k) safe harbor plans. The actual deferral percentage nondiscrimination test is deemed to be satisfied if a 401(k) plan includes certain minimum matching or nonelective contributions under either of two plan designs (referred to as a "401(k) safe harbor plan"), as well as certain required rights and features, and satisfies a notice requirement. Under one type of 401(k) safe harbor plan, the plan either (1) satisfies a matching contribution requirement, or (2) provides for a nonelective contribution to a defined contribution plan of at least 3% of an employee's compensation on behalf of each nonhighly compensated employee who is eligible to participate in the plan.

For plan years beginning after Dec. 31, 2019, the new rules change the nonelective contribution 401(k) safe harbor to provide greater flexibility, improve employee protection, and facilitate plan adoption. The new rules eliminate the safe harbor notice requirement, but maintain the requirement to allow employees to make or change an election at least once per year. The rules also permit amendments to nonelective status at any time before the 30th day before the close of the plan year. Amendments after that time are allowed if the amendment provides (1) a nonelective contribution of at least 4% of compensation (rather than at least 3%) for all eligible employees for that plan year, and (2) the plan is amended no later than the last day for distributing excess contributions for the plan year (i.e., by the close of following plan year).

Expanded portability of lifetime income options. Starting in 2020, the new rules permit certain retirement plans to make a direct trustee-to-trustee transfer to another employer-sponsored retirement plan, or IRA, of a lifetime income investment or distributions of a lifetime income investment in the form of a qualified plan distribution annuity, if a lifetime income investment is no longer authorized to be held as an investment option under the plan. This change permits participants to preserve their lifetime income investments and avoid surrender charges and fees.

Qualified employer plans barred from making loans through credit cards and similar arrangements. For loans made after Dec. 20, 2019, plan loans may no longer be distributed through credit cards or similar arrangements. This change is intended to ensure that plan loans are not used for routine or small purchases, thereby helping to preserve retirement savings.

Nondiscrimination rules modified to protect older, longer service participants in closed plans. Starting in 2020, the nondiscrimination rules as they pertain to closed pension plans (i.e., plans closed to new entrants) are being changed to permit existing participants to continue to accrue benefits. The modification will protect the benefits for older, longer-service employees as they near retirement.

Plans adopted by filing due date for year may be treated as in effect as of close of year. Starting in 2020, employers can elect to treat qualified retirement plans adopted after the close of a tax year, but before the due date (including extensions) of the tax return, as having been adopted as of the last day of the year. The additional time to establish a plan provides flexibility for employers who are considering adopting a plan, and the opportunity for employees to receive contributions for that earlier year.

New annual disclosures required for estimated lifetime income streams. The new rules (starting at a to-be-determined future date) will require that plan participants' benefit statements include a lifetime income disclosure at least once during any 12-month period. The disclosure will have to illustrate the monthly payments the participant would receive if the total account balance were used to provide lifetime income streams, including a qualified joint and survivor annuity for the participant and the participant s surviving spouse and a single life annuity.

Fiduciary safe harbor added for selection of annuity providers. When a plan sponsor selects an annuity provider for the plan, the sponsor is considered a plan "fiduciary," which generally means that the sponsor must discharge his or her duties with respect to the plan solely in the interests of plan participants and beneficiaries (this is known as the "prudence requirement").

Starting on Dec. 20, 2019 (the date the SECURE Act was signed into law), fiduciaries have an optional safe harbor to satisfy the prudence requirement in their selection of an insurer for a guaranteed retirement income contract, and are protected from liability for any losses that may result to participants or beneficiaries due to an insurer's future inability to satisfy its financial obligations under the terms of the contract. Removing ambiguity about the applicable fiduciary standard eliminates a roadblock to offering lifetime income benefit options under a plan.

Increased penalties for failure-to-file retirement plan returns. Starting in 2020, the new rules modify the failure-to-file penalties for retirement plan returns.

The penalty for failing to file a Form 5500 (for annual plan reporting) is changed to $250 per day, not to exceed $150,000.

A taxpayer's failure to file a registration statement incurs a penalty of $10 per participant per day, not to exceed $50,000.

The failure to file a required notification of change results in a penalty of $10 per day, not to exceed $10,000.

The failure to provide a required withholding notice results in a penalty of $100 for each failure, not to exceed $50,000 for all failures during any calendar year.

SECURE Act provisions affecting individuals

Here is a look at some of the more important elements of the SECURE Act that have an impact on individuals. The changes in the law might provide you and your family with tax-savings opportunities. However, not all of the changes are favorable, and there may be steps you could take to minimize their impact. Please give me a call if you would like to discuss these matters.

Repeal of the maximum age for traditional IRA contributions. Before 2020, traditional IRA contributions were not allowed once the individual attained age 70½. Starting in 2020, the new rules allow an individual of any age to make contributions to a traditional IRA, as long as the individual has compensation, which generally means earned income from wages or self-employment.

Required minimum distribution age raised from 70½ to 72. Before 2020, retirement plan participants and IRA owners were generally required to begin taking required minimum distributions, or RMDs, from their plan by April 1 of the year following the year they reached age 70½. The age 70½ requirement was first applied in the retirement plan context in the early 1960s and, until recently, had not been adjusted to account for increases in life expectancy.

For distributions required to be made after Dec. 31, 2019, for individuals who attain age 70½ after that date, the age at which individuals must begin taking distributions from their retirement plan or IRA is increased from 70½ to 72.

Partial elimination of stretch IRAs. For deaths of plan participants or IRA owners occurring before 2020, beneficiaries (both spousal and non-spousal) were generally allowed to stretch out the tax-deferral advantages of the plan or IRA by taking distributions over the beneficiary's life or life expectancy (in the IRA context, this is sometimes referred to as a "stretch IRA").

However, for deaths of plan participants or IRA owners beginning in 2020 (later for some participants in collectively bargained plans and governmental plans), distributions to most non-spouse beneficiaries are generally required to be distributed within ten years following the plan participant's or IRA owner's death (10-year rule). So, for those beneficiaries, the "stretching" strategy is no longer allowed.

Exceptions to the 10-year rule are allowed for distributions to (1) the surviving spouse of the plan participant or IRA owner; (2) a child of the plan participant or IRA owner who has not reached majority; (3) a chronically ill individual; and (4) any other individual who is not more than ten years younger than the plan participant or IRA owner. Those beneficiaries who qualify under this exception may generally still take their distributions over their life expectancy (as allowed under the rules in effect for deaths occurring before 2020).

Expansion of Section 529 education savings plans to cover registered apprenticeships and distributions to repay certain student loans. A Section 529 education savings plan (a 529 plan, also known as a qualified tuition program) is a tax-exempt program established and maintained by a state, or one or more eligible educational institutions (public or private). Any person can make nondeductible cash contributions to a 529 plan on behalf of a designated beneficiary. The earnings on the contributions accumulate tax-free. Distributions from a 529 plan are excludable up to the amount of the designated beneficiary's qualified higher education expenses.

Before 2019, qualified higher education expenses didn't include the expenses of registered apprenticeships or student loan repayments.

But for distributions made after Dec. 31, 2018 (the effective date is retroactive), tax-free distributions from 529 plans can be used to pay for fees, books, supplies, and equipment required for the designated beneficiary s participation in an apprenticeship program. In addition, tax-free distributions (up to $10,000) are allowed to pay the principal or interest on a qualified education loan of the designated beneficiary, or a sibling of the designated beneficiary.

Kiddie tax changes. In 2017, Congress passed the Tax Cuts and Jobs Act (TCJA, P.L. 115-97), which made changes to the so-called "kiddie tax," which is a tax on the unearned income of certain children. Before enactment of the TCJA, the net unearned income of a child was taxed at the parents' tax rates if the parents' tax rates were higher than the tax rates of the child.

Under the TCJA, for tax years beginning after Dec. 31, 2017, the taxable income of a child attributable to net unearned income is taxed according to the brackets applicable to trusts and estates. Children to whom the kiddie tax rules apply and who have net unearned income also have a reduced exemption amount under the alternative minimum tax (AMT) rules.

There had been concern that the TCJA changes unfairly increased the tax on certain children, including those who were receiving government payments (i.e., unearned income) because they were survivors of deceased military personnel ("gold star children"), first responders, and emergency medical workers.

The new rules enacted on Dec. 20, 2019, repeal the kiddie tax measures that were added by the TCJA. So, starting in 2020 (with the option to start retroactively in 2018 and/or 2019), the unearned income of children is taxed under the pre-TCJA rules, and not at trust/estate rates. And starting retroactively in 2018, the new rules also eliminate the reduced AMT exemption amount for children to whom the kiddie tax rules apply and who have net unearned income.

Penalty-free retirement plan withdrawals for expenses related to the birth or adoption of a child. Generally, a distribution from a retirement plan must be included in income. And, unless an exception applies (for example, distributions in case of financial hardship), a distribution before the age of 59½ is subject to a 10% early withdrawal penalty on the amount includible in income.

Starting in 2020, plan distributions (up to $5,000) that are used to pay for expenses related to the birth or adoption of a child are penalty-free. That $5,000 amount applies on an individual basis, so for a married couple, each spouse may receive a penalty-free distribution up to $5,000 for a qualified birth or adoption.

Taxable non-tuition fellowship and stipend payments are treated as compensation for IRA purposes. Before 2020, stipends and non-tuition fellowship payments received by graduate and postdoctoral students were not treated as compensation for IRA contribution purposes, and so could not be used as the basis for making IRA contributions.

Starting in 2020, the new rules remove that obstacle by permitting taxable non-tuition fellowship and stipend payments to be treated as compensation for IRA contribution purposes. This change will enable students receiving those payments to begin saving for retirement without delay.

Tax-exempt difficulty-of-care payments are treated as compensation for determining retirement contribution limits. Many home healthcare workers do not have taxable income because their only compensation comes from "difficulty-of-care" payments that are exempt from taxation. Because those workers did not have taxable income, they were not able to save for retirement in a qualified retirement plan or IRA.

For contributions made to IRAs after Dec. 20, 2019 (and retroactively starting in 2016 for contributions made to certain qualified retirement plans), the new rules allow home healthcare workers to contribute to a retirement plan or IRA by providing that tax-exempt difficulty-of-care payments are treated as compensation for purposes of calculating the contribution limits to certain qualified plans and IRAs.