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CLIENT ALERT
SECURE Act Makes Sweeping Changes
to Qualified Retirement Plan Rules

At the end of 2019 the President signed the SECURE Act into law. The Act is arguably the most significant qualified retirement plan legislation in more than a decade. This Client Alert summarizes those provisions of the Act most likely to be of interest to our qualified retirement plan clients.

Plans will need to be operated in accordance with the applicable provisions of the Act upon their respective effective dates, which are noted below. Many, although not all, of the Act's changes become effective immediately in 2020. Plans will need to be amended to incorporate the applicable provisions of the Act by the end of 2022 unless the Internal Revenue Service (IRS) extends this deadline.

Increase in Age for Required Minimum Distributions to Age 72

A participant is generally required to begin receiving certain benefit payouts under a tax-qualified plan, referred to as "required minimum distributions" or RMDs, by his or her "required beginning date." RMDs are not eligible for tax-deferred rollover to another tax-qualified plan or individual retirement account (IRA). Under pre-Act law, a plan participant's required beginning date was April 1 of the calendar year following the calendar year in which the participant attained age 70½ (subject to an exception for non-5% owner employees who continue to work past that date). The Act pushes that age to 72.

> *Effective Date:* This new rule applies to distributions required to be made after December 31, 2019 for individuals who attain age 70½ after that date.
>
> *D&M's Perspective:*

- If you were born:
  - before July 1, 1949, the old rule (age 70½) applies to you
  - on or after July 1, 1949, the new rule (age 72) applies to you.
- For example, if a 5% owner attained age 70½ in 2019, his required beginning date remains April 1, 2020.
- Employers need to revise policies and procedures for notifying plan participants of their RMDs.

- Distribution procedures need to be revised beginning in 2020 to reflect the new rules.

    - The new rules would affect, for example, a participant born July 1, 1949 who attains age 70½ in 2020. The participant does not have to take an RMD by April 1, 2021, and any taxable distributions taken during the 2021 or 2022 tax year must be treated as being eligible for a tax-deferred rollover and subject to mandatory 20% federal income tax withholding to the extent not rolled over.

Small Employer Pension Plan Startup Credit Increase; Auto Enrollment Credit

A small employer (one with no more than 100 employees) can receive an income tax credit for costs incurred to establish and administer a new qualified retirement plan that covers at least 1 nonhighly compensated employee. The credit applies for 3 years, generally beginning with the year the plan is first effective. However, the amount of the annual credit has been modest: the lesser of (1) 50% of qualified plan startup costs, or (2) a flat dollar amount of $500 per year. The portion of qualified plan startup costs equal to the amount of the credit cannot also be deducted for income tax purposes.

The Act significantly increases the potential credit to as much as $5,000 for each of the first three plan years. The amount of the credit is now the lesser of (1) 50% of qualified plan startup costs, or (2) the greater of (a) $500 or (b) the lesser of (i) $5,000, or (ii) $250 multiplied by the number of non-highly compensated employees eligible to participate in the plan.

Under the Act, small employers that adopt an automatic enrollment feature, whether for a new or existing 401(k) plan, are eligible for an additional $500 income tax credit for three years.

Effective Date: These changes apply to taxable years beginning after 2019.

D&M's Perspective:

- In the right circumstances, these credits could substantially offset the costs incurred by a small employer to establish and initially administer a new qualified retirement plan and/or automatic enrollment feature.

- *Example*: A small employer adopts a 401(k) Profit Sharing Plan (with no auto enrollment) effective January 1, 2019, and the costs to establish and administer the plan exceed the applicable annual limitations and caps on the credit. The employer can claim a $500 credit for 2019 and a $5,000 credit for each of 2020 and 2021.

Extension of Deadline for Adopting New Retirement Plan

Previously, if an employer wanted to adopt a retirement plan for a calendar year, the employer must have adopted the plan by signing the plan document no later than December 31 of that year.

The Act extends the deadline for adopting a plan to the filing date (with extensions) for the employer's income tax return for that year. This date is September 15 of the following year for partnerships, S corporations and LLCs taxed as partnerships or S corporations. This date is October

15 of the following year for C corporations, sole proprietorships and LLCs taxed as C corporations or sole proprietorships. Note, however, that if the new plan is a defined benefit or cash balance pension plan, and the employer intends to claim a plan contribution tax deduction for the year in which the plan is first effective, then the deadline for establishing the plan and making the contribution is September 15 of the following year.

Effective Date: This new deadline applies to plans adopted for taxable years beginning after December 31, 2019.

D&M's Perspective:

- It may still be advisable to adopt a new plan by the end of the taxable year for the following reasons:
  - To preserve the ability to make 401(k) elective deferrals. 401(k) contributions can dramatically reduce the amount of profit-sharing contributions that must be made for staff participants to allow the owner to max out on his or her own contribution. If a plan is not adopted by year-end, 401(k) contributions cannot be made for that year. The Act does not change this rule.
  - To coordinate year-end tax planning.
  - To get contributions into the plan and growing on a tax-deferred basis as promptly as possible.
- On the other hand, if for whatever reason a plan is not adopted by year's end, and the employer's CPA, in preparing that year's tax return, discovers that the employer could use a plan contribution tax deduction, the new deadline allows the employer to adopt a plan for that year.

<u>Safe Harbor 401(k) Plan Changes</u>

Under existing law, design-based safe harbor 401(k) plans avoid numerical nondiscrimination testing for employee elective deferrals. Safe harbor plans provide for either an employer nonelective contribution or an employer matching contribution for eligible employees. The pre-Act safe harbor rules required, among other things, that the employer provide all eligible employees with an annual notice concerning the safe harbor contribution generally by December 1 of the year prior to the year for which the safe harbor contribution is to be made. Under another pre-Act rule, a 401(k) plan generally could not be a safe harbor plan for a plan year unless the plan document was amended to reflect the safe harbor requirements before the first day of the plan year.

The Act:

- eliminates the annual safe harbor notice requirement for nonelective safe harbor contributions (but not for matching safe harbor contributions);
- gives employers flexibility to add nonelective safe harbor contributions to a plan at

any time up until 30 days before the end of the plan year;

- ◦ A plan can be amended to add nonelective safe harbor contributions *after* this time, up until the end of the following plan year, if the nonelective safe harbor contribution is at least 4% of eligible compensation (up from 3% under the general rule).

and

- increases, from 10% to 15%, the cap on automatic elective deferrals under a "qualified automatic contribution arrangement" (QACA).

Effective Date: These new rules apply to plan years beginning after December 31, 2019.

D&M's Perspective:

- This welcome increase in administrative flexibility allows an employer with a non-safe harbor 401(k) plan to wait until late in the plan year, or even into the next plan year, to decide whether or not to adopt a non-elective safe harbor contribution feature.

- If a plan uses safe harbor matching contributions, safe harbor notices must still go out to eligible employees by December 1 of the preceding plan year.

<u>Elimination of Stretch Payouts from Qualified Plans or IRAs in Favor of 10-Year Rule</u>

The Act generally eliminates the "stretch" payout method from a qualified plan or IRA for non-spouse beneficiaries. Prior to the Act, a non-spouse beneficiary (or a trust for a non-spouse beneficiary) could take distributions over his or her life expectancy.

Under the Act, surviving non-spouse beneficiaries (or trusts for their benefit) will be required (with some limited exceptions described below) to take their benefits into income on an accelerated basis – by the end of the tenth calendar year following the year of the participant's or IRA owner's death. The following beneficiaries are excepted from the ten-year rule and therefore are still entitled to use the life expectancy method: (a) a surviving spouse, (b) disabled beneficiary, (c) minor child, (d) chronically ill individual and (e) a beneficiary who is less than ten years younger than the plan participant or IRA owner (for example, a sibling of the participant or owner who has no spouse or children).

Effective Date: These new rules apply to distributions with respect to individuals who die after December 31, 2019.

D&M's Perspective:

- Where a decedent's net worth includes retirement accounts, distributions and income tax recognition will generally be accelerated for non-spouse beneficiaries.

- For example, a common estate plan provides for the children to inherit through a trust which lasts for each child's lifetime and upon the child's death continues for the grandchildren in order to "keep the assets in the bloodline" and protect the child's inheritance from divorce or death. Under the Act, funds from a retirement account must be distributed from the trust by the tenth year after the plan participant's or IRA owner's death (or death of both spouses) to avoid tax at the trust level (or accumulated in the trust on an after-tax basis), even though trust assets from other sources will remain in the trust for the children's lifetime.

New Minimum Service Rule for 401(k) Elective Deferrals

Currently, a retirement plan can exclude employees who work less than 1,000 hours during a designated 12-month period. The Act will require 401(k) plans to extend elective deferrals to employees who work at least 500 hours during each of the immediately preceding three consecutive 12-month periods. Plans will not be required to provide employer contributions for these employees.

Effective Date: This new rule will apply to plan years beginning after December 31, 2020. However, the 12-month measurement periods under this rule begin January 1, 2021.

D&M's Perspective:

- Plan sponsors will need to begin identifying and tracking hours of service of long-term part-time employees beginning in 2021.

- However, actual eligibility to participate under this new rule will effectively be delayed until 2024.

- Importantly, these part-time employees will not be required to receive any employer contributions, such as safe harbor or top-heavy contributions.

Other Changes

Combined Form 5500s for Group of Defined Contribution Plans. Currently, multiple defined contribution plans sponsored by a single employer must each file their own annual informational returns on Form 5500-series. The Act will allow a group of defined contribution plans to file a single annual Form 5500 if the plans all have the same trustee, named fiduciary, plan year, administrator, and investments or investment options. IRS and DOL will need to issue revised rules by the end of 2021 to implement combined reporting. The revised rules will apply to plan years beginning after 2021.

Lifetime Income Disclosure in Benefit Statements. The Act requires annual lifetime income disclosures illustrating the estimated monthly income that a participant could receive if an annuity were purchased with the participant's plan account balance, whether or not the plan provides for annuity distributions. Benefit statements furnished more than 12 months after Department of Labor (DOL) issues a model disclosure and other implementing rules (which are required to be issued by December 2020) must first include the new disclosures.

Other Lifetime Income Investment Changes. The Act adds limited conditional fiduciary liability relief for the selection of lifetime income investment providers for a plan. This relief is effective immediately. The Act also provides that if a plan eliminates a lifetime income investment option, the plan can be amended to allow plan participants who are invested in such option to avoid incurring surrender charges or penalties by taking an in-kind distribution of the investment without regard to the plan's otherwise applicable limitations on in-service distributions. This change is effective for plan years beginning after 2019.

Minimum Age for In-Service Pension Plan Distributions. The Act allows defined benefit pension plans to permit in-service distributions beginning at age 59½. This provision applies to plan years beginning after December 31, 2019.

Repeal of Maximum Age for Traditional IRA Contributions. The Act repeals the maximum age (previously 70½) for making contributions to a traditional IRA for taxable years beginning after December 31, 2019.

If you have any questions concerning the SECURE Act, please feel free to contact
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