WRMarketplace

An AALU Washington Report

This WR Marketplace is created exclusively for AALU members by experts at K&L Gates and the AALU staff, led by **James E. Earle, Matthew R. Jones, Richard H. Nettles, and Rebecca Liu.**

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TOPIC: The House Passed Comprehensive Retirement Legislation Aiming to Improve the Nation's Retirement System.

MARKET TREND: On May 23, 2019, the House passed the Setting Every Community Up for Retirement Enhancement Act (SECURE Act - H.R. 1994), a bill that seeks to close the gap that exists between the resources Americans currently have for retirement and the resources that they will need when they retire.

SYNOPSIS: The SECURE Act, which passed in the House by a vote of 417-3 and is now being pushed in the Senate, contains29 different provisions that generally aim to make it easier for smaller employers to offer access to retirement plans, incentivize employees to participate in retirement plans, and encourage plan participants to use lifetime income products. The Act's wide-ranging provisions include modifying the qualification requirements for certain multiple employer plans, easing non-discrimination testing for 401(k) and certain frozen defined benefit plans, increasing the automatic-enrollment safe harbor cap, repealing the maximum age for traditional IRA contributions, providing portability of lifetime income investments, increasing the age for required minimum distributions and eliminating so-called "stretch IRAs," as well as other changes. If passed, the bill would be a significant reform to the nation's retirement system.

AALU has been working with ACLI and NAIFA as well as other partners to pass the SECURE Act in the Senate this summer. We also support the Retirement Enhancement and Savings Act (RESA), a retirement package that shares many of the provisions of the SECURE Act—with some differences—and enjoys bipartisan support. We will update members on the progress of the bills over the next few months.

TAKEAWAYS: If the SECURE Act passes, it will change many of the laws that currently govern the retirement system. Plan sponsors will want to monitor how the Act progresses in the Senate and be aware of the potential changes to come.

Multiple Employer Plan Expansion

For certain small employers, maintaining a retirement plan can be prohibitively costly. Consequently, some employers come together to offer a single, "multiple employer plan" under Section 413(c) of the Internal Revenue Code (the "Code"), to take advantage of economies of scale. However, under current law, the availability of multiple employer plans is limited. To be treated as a single plan under the Employee Retirement Income Security Act of 1974 ("ERISA"), the participating unrelated businesses must have a sufficient business interest.[1] Further, multiple employer plans are subject to the "one bad apple" rule, meaning that a disqualifying defect by any one adopting employer in a plan can disqualify the entire plan.[2]

The Act would ease the existing rules on multiple employer plans for plan years beginning after December 31, 2020 by eliminating the sufficient business interest requirement. Unrelated employers without a business relationship could participate in a multiple employer plan through a "Pooled Plan Provider." The Pooled Plan Provider would serve as the named fiduciary of the plan and would be responsible for administrative duties. As a named fiduciary, the Pooled Plan Provider could be assigned most of the plan's fiduciary obligations under ERISA, reducing the fiduciary burdens for participating employers. Further, the Act eliminates the application of the "one bad apple" rule if the assets and liabilities of the plan attributable to the noncompliant employer are spun-off into a separate plan, thereby making participation in a multiple employer plan less risky.

401(k) Safe Harbor Rules Eased for Nondiscrimination Testing

The 401(k) safe harbor rules allow plans to avoid the annual nondiscrimination testing in certain circumstances.

1. Nonelective Contributions and Notice Requirements

Under the existing 401(k) plan safe harbor rules, employers are required to make either a minimum matching contribution to employees' accounts or a "nonelective" contribution equal to 3% of an employee's compensation.[3] To qualify for safe harbor status, a safe harbor notice must be distributed to plan participants prior to the beginning of each plan year.[4] As a result of these notice requirements, an employer cannot decide to utilize a safe harbor feature after a plan year begins.

For plan years beginning after December 31, 2019, the Act would permit an employer to add a safe harbor feature to its plans up to 30 days prior to the end of the plan year if it has

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[1] DOL Advisory Opinion 2012-04A.
[2] Treas. Reg. Sec. 1.413-2(a)(3)(iv).
[3] Code Sec. 401(k)(13).
[4] Code Secs. 401(k)(12), 401(k)(13).

made a 4% nonelective contribution for the plan year, even if no safe harbor distribution notice was provided to participants.

2. Automatic Enrollment Rate Cap Increase

Certain plans that automatically enroll employees at default contribution rates can be exempt from certain nondiscrimination testing. Under the current safe harbor rules, the maximum default contribution rate cannot exceed 10%. The Act would raise the cap on automatic enrollment to 15% after the first year the employee has been enrolled in the plan for all plan years beginning after December 31, 2020.

Small Employer Tax Credits for Pension Plan Startup Costs

To encourage small businesses to establish retirement plans and to ease the financial cost of doing so, Code Section 45E allows employers with 100 or fewer employees to claim tax credits for 50% of the start-up costs related to the establishment of certain retirement plans, up to a cap of $500. For tax years begging after December 31, 2019, the Act increases this cap to $5000 for plans with more than 20 non-highly compensated employees. For plans with three to 20 non-highly compensated employees, the cap is increased to $250 per non-highly compensated employee. Further, the SECURE Act creates an additional tax credit of $500 for a three-year period if the plan includes an automatic enrollment feature.

401(k) Plan Participation Open to Long-Term Part-Time Employees

Employers generally design their retirement plans to exclude employees that do not complete 1,000 hours of service during a plan year.[5] Consequently, many part-time employees are excluded from participating in their employer's plans.

Under the Act, employers would be required to permit a non-union employee over age 21 to make elective deferrals to its 401(k) plan if the employee worked at least 500 hours per year for three consecutive years. Employers would not be required to include the part-time employee in any safe harbor features, such as safe harbor employer matching or nonelective contributions. The part-time employee also may be excluded from the plan's top-heavy minimum contribution and vesting requirements and may otherwise be separately tested for nondiscrimination purposes.

Exception to Early Distribution 10% Excise Tax for Birth or the Adoption of a Child

Existing law imposes a 10% excise tax on any taxable distribution from a retirement plan or individual retirement account ("IRA") that is made prior to an individual attaining age 59½ unless an exception applies.[6] The Act creates a new exception that exempts up to $5,000 of a distribution from the 10% excise tax if made during the one-year period beginning on the date of the birth or eligible adoption of the individual's child. Individuals would also be permitted to recontribute the amount withdrawn to a rollover-eligible retirement account after the distribution is made. The exception would apply to all distributions made after December 31, 2019.

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[5] Code Sec. 410(a)(3)(A).

[6] Code Sec. 72(t).

Non-Discrimination Testing for "Soft" Frozen Defined Benefit Plans

Qualified retirement plans are subject to qualification rules that prohibit discrimination in favor of highly compensated employees with respect to plan benefits, rights, or features.[7] These rules can be difficult to satisfy for defined benefit plans that have been "frozen" or closed to new participants, as older, longer-service participants may be eligible for generous benefits under the plan. The Act provides nondiscrimination testing relief for plans that were closed prior to April 5, 2017 or that are closed after April 5, 2017 if the plan was in effect for at least five years prior to the freeze and did not experience substantial increases in coverage or the value of the benefits. If certain requirements are met,[8] the Act permits these defined benefit plans to be tested on an aggregated basis with the employer's defined contribution plans.

Defined Contribution Plan Lifetime Income Annuities

1. *Portability of Lifetime Income Investments*

Under present law, participants have no right to retain a specific investment option under a qualified retirement plan, including annuity contracts or other lifetime income investments. Due to restrictions on the ability to withdraw funds from the retirement plan, if a plan discontinues its annuity contract investment option, participants have no choice but to invest their plan account in funds that do not provide lifetime income. For plan years beginning after December 31, 2019, the Act would permit a participant to receive a distribution of the discontinued annuity contracts or lifetime income investments in the form of an individual annuity, regardless of whether the participant was otherwise eligible for a distribution from the plan.[9]

2. *Benefit Statement Disclosures*

Defined contribution plans often do not offer benefits in the form of annuities or other lifetime-income payment options (in contrast to defined benefit plans), and plan participants often do not understand how to evaluate the lifetime income stream that could be provided by their account balance.[10] The Act would require plan administrators to disclose the monthly lifetime equivalent benefit of a participant's account balance in the form of a single or qualified joint and survivor annuity.[11] The disclosure must be provided in at least one of the benefit statements required under ERISA Section 105[12] during any 12-month period. The Department of Labor is required to issue a model lifetime disclosure.

3. *Fiduciary Safe Harbor for Selection of Annuity Provider*

Under current law, ERISA imposes robust duties on plan fiduciaries, including the obligation to discharge plan duties solely in the interest of participants and beneficiaries, for the exclusive purpose of providing benefits to participants and beneficiaries and defraying reasonable administrative expenses, with the care, skill, prudence, and diligence of a prudent

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[7] Code Secs. 401(a)(3)-(5), 410(b).
[8] For example, aggregation is permitted with a defined contribution plan that, among other things, issues a "make whole" contribution to the class of employees whose benefits were frozen.
[9] H.R. 1994 Sec. 109; Code Secs. 401(a), 403(b), 457(d).
[10] H. COMM. ON WAYS AND MEANS, Rep. No. 116-65 at 83 (2019).
[11] H.R. 1994 Sec. 203; ERISA Sec. 105.
[12] Benefit statements must be provided at least quarterly for defined contribution plans with participant-directed accounts and annually for all other defined contribution plans.

person under the circumstances.[13] The last requirement is known as the "prudent man" rule. With respect to selecting annuity providers and contracts for benefit distributions from a defined contribution plan, Department of Labor (DOL) regulations provide a safe harbor for plan fiduciaries to satisfy the prudent man rule.[14]

Building on the DOL regulation, the Act would provide specific measures plan fiduciaries may take to ease the burden to satisfy the prudent man rule when selecting an annuity provider, including determining whether the provider is financially capable of satisfying its obligations under the contract. The safe harbor does not extend to the approval of the underlying contract. This provision is effective on the date of enactment.

Required Minimum Distributions

1. *Increase in Mandatory Commencement Age*

Under existing law, minimum distributions from retirement plans and IRAs must begin no later than the year following the year in which the individual reaches age 70½. Failure to comply with this requirement results in a 50% excise tax on the required minimum distribution.[15] The Act increases the age after which required minimum distributions must begin to age 72.[16] The change is effective for distributions required to be made for employees and IRA owners who attain 70½ after December 31, 2019.

2. *Post-Death Distribution Timing for Designated Beneficiaries*

Under existing law, the timing of required minimum distributions after the death of the employee or IRA owner depends on whether the death occurs before or after the required beginning date and whether there is a designated beneficiary. In many cases, require minimum distributions may be paid over the designated beneficiary's lifetime, which can be particularly beneficial when the designated beneficiary is much younger than the employee or IRA owner. (Inherited IRAs of this nature are commonly called "stretch IRAs.") Under the Act, the required minimum distribution period for certain designated beneficiaries would be limited to ten years following the employee's or IRA owner's death, rather than the beneficiary's lifetime. This ten-year limit would not apply when the beneficiary is the employee's or IRA owner's spouse or disabled or chronically ill child. In addition, if the beneficiary is a minor age at the time of the employee's or IRA owner's death, the ten-year distribution period does not begin until the child reaches majority.

This change is generally effective with respect to employees or IRA owners who die after December 31, 2019. There is a delayed effective date for government plans and collectively bargained plans, and special rules apply when the employee or IRA owner dies before the effective date of the change.

Administrative Changes

1. *Deadline for Adopting a Tax-Qualified Retirement Plan*

[13] ERISA Sec. 404.
[14] *See* 29 C.F.R. Sec. 2550.404a-4.
[15] Code Sec. 4974.
[16] See H.R. 1994 Sec. 114; Code Sec. 401(a)(9).

An employer may adopt a qualified retirement plan after the close of a taxable year if the plan is adopted by the due date for filing the employer's tax return (including extensions).[17] The change applies to plans adopted for taxable years beginning after December 31, 2019.

2. *Combined Form 5500 Filing for Certain Defined Contribution Plans*

The Act would permit members of certain groups of defined contribution plans to file a single, combined Form 5500 for the group if the plans (i) have the same trustee, same named fiduciary (or named fiduciaries) under ERISA, and the same plan administrator, (ii) use the same plan year, and (iii) provide the same investments or investment options to participants and beneficiaries.[18] Non-ERISA plans may join the group if the same person performing the noted functions for the other plans performs each of the functions for the non-ERISA plan.

3. *Increased Failure to File Penalties*

Responding to the fact that penalties for failing to file individual and retirement plan returns have not increased in several years,[19] the Act provides for increased penalties.[20] For retirement plans, the penalty for failing to file a Form 5500 is increased to $105 per day (up to $50,000 per plan sponsor). The penalty for failing to file a deferred vested benefit statement is increased to $2 per participant per day (not exceeding $10,000 for the plan year). The penalty for failing to file a required notification of change is increased to $2 for each day the failure continues (not exceeding a maximum penalty of $5,000 for any failure). The penalty for failing to provide a required withholding notice is increased to $100 for each failure (not exceeding $50,000 for all failures during a calendar year). These changes are generally effective after December 31, 2019.

Other Provisions

1. *Difficulty of Care and Non-Tuition Fellowships and Stipend Payments Treated as Compensation* - The Act provides that difficulty of care payments made to qualified foster care providers is treated as compensation for purposes of contributing to a qualified retirement plan or IRA and that payments related to graduate or postdoctoral study or research is treated as compensation for IRA contribution purposes.[21]

2. *Multiemployer Plans of Cooperatives or Charities* - The Act reduces PBGC premiums (classified as offsetting receipts) paid by multiemployer plans of cooperatives or charities.[22]

3. *Community Newspaper Pension Plans* - The Act permits community newspaper pension plans to elect alternative minimum funding rules.[23]

[17] H.R. 1994 Sec. 201; Code Sec. 401(b).
[18] H.R. 1994 Sec. 202; Code Sec. 6058; ERISA Sec. 104.
[19] H. COMM. ON WAYS AND MEANS, Rep. No. 116-65 at 113, 115 (2019).
[20] H.R. 1994 Secs. 402, 403; Code Secs. 6651(a), 6652(d), (e), (h).
[21] H.R. 1994 Secs. 106, 116; Code Secs. 131, 219, 408, 415.
[22] H.R. 1994 Sec. 206; ERISA Sec. 4006.
[23] H.R. 1994 Sec. 115; Code Sec. 430; ERISA Sec. 303.

4. *Retirement Income Rules for Church-Related Organizations* - The Act clarifies that retirement income accounts may cover ministers, employees of an organization exempt from tax under Code Section 501 and controlled by or associated with a church or association of churches, and employees included in a church plan after separation from service.[24]

5. *In-Kind Distribution of 403(b) Custodial Accounts* - The Act directs the Internal Revenue Service to issue guidance that would permit custodial accounts under a 403(b) plan to be distributed to participants in-kind when terminating a 403(b) plan. The custodial accounts would retain their tax-advantaged status as 403(b) custodial accounts and would not be taxable until the assets are later distributed.

The Senate's Similar Proposed Legislation - RESA (S. 972)

The Senate is also considering the Retirement Enhancement and Savings Act (RESA - S. 972). RESA contains a number of provisions similar to the SECURE Act, including (1) easing requirements for multiple employer plans and providing standards for service providers; (2) removing the cap on matching contributions of automatic enrollment safe harbor plans after the first of the year; (3) requiring post-death distributions to designated beneficiaries exceeding $400,000 to be distributed within 5 years; (4) increasing the credit for small employer pension startup costs; (5) making changes to IRAs that designate fellowship stipends as compensation and repeal the maximum age for contributions); (6) disallowing plan loans through credit cards and similar arrangements; (7) allowing the transfer of lifetime income investments; (8) allowing the conversion of terminated custodial accounts for 403(b) plans to be converted to an IRA; (9) increasing the required minimum distribution age to 75; and (10) clarifying the persons covered by church-controlled plans. Unlike the SECURE Act, RESA also expands IRA ownership of S Corporation bank stock. If the SECURE Act passes, some of RESA's provisions may make it into the final legislation.

Conclusion

The SECURE Act (and other recently proposed legislation) reflect Congress' desire to makes it easier for Americans to use employer-sponsored retirement plan accounts and IRAs to save for retirement and for employers to offer retirement plans to their employees. The Act reflects various House and Senate proposals offered throughout the past several years.[25]

AALU is working with ACLI and NAIFA as well as others to pass the bill in the Senate this summer, and we will keep members informed of the latest developments.

[24] H.R. 1994 Sec. 111; Code Sec. 403(b)(9).
[25] *See, e.g.*, Retirement Enhancement and Savings Act of 2019, H.R. 1007 (116th Cong.); Retirement Security Act of 2019, S. 321 (116th Cong.); Family Savings Act of 2018, H.R. 6757 (115th Cong.); Retirement Enhancement and Savings Act of 2016, S. 3471 (114th Cong.).