The SECURE Act

What It Is And What It Means For Investors

On December 20, 2019 the President signed the 2020 budget bill containing the Setting Every Community Up for Retirement Enhancement (SECURE) Act, clearing the way for one of the most substantial pieces of retirement plan legislation in years to become law. The SECURE Act found new life at the eleventh hour of the 2019 legislative session as an attachment to the must-pass $1.4 trillion spending bill, which passed by significant margins.

The SECURE Act brings quite a few changes that will affect IRA owners, plan sponsors and participants. It is intended to incentivize employers to offer retirement plans, promote additional retirement savings, and enhance retiree financial security, including several provisions that will impact current plan administration. While some changes are positive, certain ones will create new administrative challenges and questions. In addition, further regulatory guidance will be necessary to clarify certain definitions and the manner under which many provisions will apply. A general summary of the provisions of the SECURE Act is below.

Increase from age 70 ½ for required minimum distributions (RMDs) to age 72. The RMD age is raised to age 72, effective for distributions after 2019 with respect to individuals who attain age 70 ½ after 2019. If an individual attains age 70 ½ or older in 2019, such individual will need to take a RMD for 2019 and 2020, even though he or she may not attain age 72 until 2021.

Beneficiary stretch provision. Currently, after the death of an IRA owner or participant in a defined contribution plan (e.g. 401(k) and profit sharing plans) the beneficiary is typically permitted to draw down the IRA or plan benefits over the beneficiary's life expectancy. Beginning with the year 2020, if an IRA or plan participant dies designated beneficiaries are generally required to draw down all assets in the IRA or plan within 10 years of the death of the IRA owner or plan participant, subject to a few exceptions below.

The new rule does not apply to a beneficiary who is (1) the surviving spouse, (2) a child who has not attained the age of majority, (3) disabled, (4) chronically ill, or (5) not more than 10 years younger than the IRA owner or plan participant. In the case of a child who has not attained the age of majority, the ten-year rule would apply as of the date the child attains the age of majority. Also, the new rule does not apply to defined benefit pension plans. Finally, there are delayed effective dates for collectively bargained and governmental plans and for making plan amendments.

Post-70 ½ contributions to a traditional IRA. Currently, an individual who has attained age 70 ½ by the end of the year cannot make a contribution to a traditional IRA. This age limitation is repealed effective with the 2020 year.

Adoption of a plan. Currently, a plan must be adopted by the end of the employer's taxable year to be effective for that year. For plan years beginning after 2019, the SECURE Act allows an employer to adopt a plan as long as it is adopted by the due date for the tax return for that year.

Open MEPs and repeal of the one bad apple rule. This provision (1) allows completely unrelated employers to participate in a multiple employer defined contribution plan ("open MEP"), and (2) generally eliminates the rule under which the violation of the qualification rules by one employer in a defined contribution MEP disqualifies the entire MEP (thus eliminating the "one bad apple rule"). This provision is effective for plan years beginning after December 31, 2020.

401(k) participation for long-term part-time workers. Under current law, employers with a 401(k) generally may exclude from plan participation employees who have not satisfied a requirement that they have 1,000 hours of service in a year. The Act requires employers with a 401(k) to include employees with three consecutive years of service where the employee completes at least 500 hours of service in each year. For employees who become eligible under this new rule, the employer (1) is not required to provide any matching or nonelective contributions, and (2) may elect to exclude such employees from testing under the nondiscrimination and coverage rules (including the 401(k) safe harbor rules), and from the application of the top-heavy rules. This provision applies to plan years beginning after December 31, 2020.

Lifetime income disclosure. The SECURE Act requires a benefit statement provided to a defined contribution plan participant to annually include a lifetime income disclosure. The disclosure must set forth the lifetime income stream equivalent of the participant's total plan balance in the form of an annuity. If the disclosure is made using DOL-prescribed assumptions and explanations, the plan sponsor would not have liability attributable to the lifetime income disclosure. This requirement applies to statements provided more than 12 months after the Department of Labor issues "interim final rules" and a model disclosure.

Fiduciary safe harbor for selecting an annuity provider. Effective as of the date of enactment of the Act, this provision provides certainty for qualified plan sponsors for the selection of lifetime income providers, which is a fiduciary act under ERISA. The Act provides fiduciaries with an optional safe harbor to satisfy the prudence requirement for the selection of insurers for a guaranteed retirement income contract (e.g. an annuity) and are protected from liability for any losses that may result to the participant or beneficiary due to an insurer's inability in the future to satisfy its financial obligations under the terms of the contract.

Penalty-free distributions upon the birth or adoption of a child. Effective for distributions made after December 31, 2019, upon birth or adoption of a child an individual may withdraw up to $5,000 penalty-free from a defined contribution plan or IRA. These withdrawals may be repaid to such a retirement account.

Increasing the 10% limit on 401(k) plan automatic escalation to 15%. Under current safe harbor rules, if a plan uses automatic enrollment and automatic escalation it may not automatically enroll or escalate employees so that contributions exceed 10% of pay. Effective for plan years beginning after December 31, 2019, the SECURE Act maintains the 10% cap for the first year in which the employee is automatically enrolled but increases the limit to 15% after that first year.

Expanded uses for 529 accounts. As of the date of enactment, the Act permits 529 accounts to make tax-free distributions to pay for certain apprenticeship programs and student loans up to a lifetime limit of $10,000.

Electing safe harbor 401(k) status. The Act streamlines compliance for 401(k) plans that meet the nondiscrimination test (ADP, ACP, etc.) safe harbors by eliminating the notice requirement with respect to plans that satisfy the safe harbor through the use of nonelective contributions, and also allowing a plan to elect safe harbor status after the beginning of the plan year but before the 30th day before the close of the plan year, if certain conditions are satisfied.

Increased credits for small business retirement plans. Under current law, small employers are entitled to an annual tax credit for three years equal to 50% of the costs of starting up and administering a retirement plan, up to a cap on the annual credit of $500. Effective for tax years beginning after December 31, 2019, the Act increases the $500 cap to the greater of (1) $500 or (2) the lesser of: (a) $250 multiplied by the number of nonhighly compensated employees eligible to participate in the plan or (b) $5,000.

In addition, small employers that adopt automatic enrollment provisions are eligible for an additional $500 credit for three years, regardless of whether the automatic enrollment provisions are adopted when the plan is first effective, or the provisions are adopted later.

IRA contributions of stipend payments. An amount that is taxable and paid to an individual to help the individual with respect to graduate or postdoctoral studies is treated as compensation on which IRA contributions can be based. This rule is effective for tax years beginning after December 31, 2019.

Credit card loans from qualified retirement plans. The Act prohibits credit card loans from plans after December 31, 2019.

Portability of lifetime income products. The Act facilitates portability of lifetime income products held in defined contribution retirement plans. For plan years beginning after December 31, 2019, plan participants are allowed to take a distribution of a "lifetime income investment" without regard to the restrictions on plan withdrawals if (1) the lifetime income investment is no longer authorized to be held under the plan, and (2) the distribution is made via (a) a direct rollover to an IRA or other retirement plan, or (b) a distribution of an annuity contract.

Treatment of custodial accounts on termination 403(b) plans. Under the provision, not later than six months after the date of enactment Treasury will issue guidance under which if an employer terminates a 403(b) custodial account, the distribution needed to complete the plan termination may be the distribution of an individual custodial account in kind to a participant or beneficiary. The individual custodial account will be maintained on a tax-deferred basis as a 403(b) custodial account until paid out, subject to the 403(b) rules in effect at the time that the individual custodial account is distributed. The Treasury guidance shall be retroactively effective for taxable years beginning after Dec. 31, 2008.

Combined annual report for group of plans. The Act directs the IRS and DOL to effectuate the filing of a consolidated Form 5500 for similar plans. Plans eligible for consolidated filing must be defined contribution plans, with the same trustee, the same fiduciary (or named fiduciaries) under ERISA, and the same administrator, using the same plan year, and providing the same investments or investment options to participants and beneficiaries. The change is intended to reduce aggregate administrative costs, making it easier for small employers to sponsor a retirement plan and thus improving retirement savings.

Other revenue raisers. In addition to the "stretch" provision described above, the SECURE Act contains additional provisions to offset the cost of the Act including increases to the penalties for failure to file Form 5500, the registration statement regarding deferred vested participants, or provide participants with a required withholding notice.