New Spending Package Includes Sweeping Retirement Plan Changes

The $1.4 trillion spending package enacted on December 20, 2019, included the Setting Every Community Up for Retirement Enhancement (SECURE) Act, which had overwhelmingly passed the House of Representatives in the spring of 2019, but then subsequently stalled in the Senate.

The SECURE Act represents the most sweeping set of changes to retirement legislation in more than a decade.

While many of the provisions offer enhanced opportunities for individuals and small business owners, there is one notable drawback for investors with significant assets in traditional IRAs and retirement plans. These individuals will likely want to revisit their estate-planning strategies to prevent their heirs from potentially facing unexpectedly high tax bills.

All provisions took effect on or after January 1, 2020, unless otherwise noted.

Limitations on the "Stretch IRA"

Perhaps the change requiring the most urgent attention is the elimination of longstanding provisions allowing non-spouse beneficiaries who inherit traditional IRA and retirement plan assets to spread distributions — and therefore the tax obligations associated with them — over their lifetimes. This ability to spread out taxable distributions after the death of an IRA owner or retirement plan participant, over what was potentially such a long period of time, was often referred to as the "stretch IRA" rule.

The new law modifies the required minimum distribution rules, with respect to defined contribution plans and IRA account balances, upon the death of the account owner. Under the new legislation, distributions to an individual who is more than 10 years younger than the account owner, is not the surviving spouse, a disabled or chronically ill individual or a child who has not reached the age of 18[1] are generally required to be distributed by the end of the 10th calendar year following the year of the plan participant or IRA account owner’s death.

In addition to possibly reevaluating beneficiary choices, traditional IRA owners may want to revisit how IRA dollars fit into their overall estate planning strategy. For example, it may make sense to consider the possible implications of converting traditional IRA funds to Roth IRAs, which can be inherited income tax free. Although Roth IRA conversions are taxable events, investors who spread out a series of conversions over the next several years may benefit from the lower income tax rates that are set to expire in 2026.

Benefits to Employers

The SECURE Act also provides assistance to employers striving to provide quality retirement savings opportunities to their workers. Among the changes are the following:

- The tax credit that small businesses can take for starting a new retirement plan has increased. The new rule allows employers to take a credit equal to the greater of (1) $500 or (2) the lesser of (a) $250 times the number of non-highly compensated eligible employees or (b) $5,000. The credit applies for up to three years. The previous maximum credit amount allowed was 50% of startup costs up to a maximum of $1,000 (i.e., a maximum credit of $500).

- A new tax credit of up to $500 is available for employers that launch a SIMPLE IRA or 401(k) plan with automatic enrollment. The credit applies for three years.

- With regards to the new mandate to permit certain part-timers to participate in retirement plans, employers may exclude such employees for nondiscrimination testing purposes.

- Employers now have easier access to join multiple employer plans (MEPs) regardless of industry, geographic location, or affiliation. "Open MEPs," as they have become known, offer economies of scale, allowing small employers access to the types of pricing models and other benefits typically reserved for large organizations. (Previously, groups of small businesses had to be affiliated somehow in order to join an MEP.) The legislation also provides that the failure of one employer in an MEP to meet plan requirements will not cause others to fail, and that plan assets in the failed plan will be transferred to another. (This rule is effective for plan years that began on or after January 1, 2021.)

- Auto-enrollment safe harbor plans may automatically increase participant contributions until they reach 15% of salary. The previous ceiling was 10%.

- The safe harbor notice requirement for non-elective contributions is eliminated, but maintains the requirement to allow employees to make or change an election at least once per year. Employers are also allowed to switch to a safe harbor 401(k) plan with non-elective contributions at any time before the 30th day before the close of the plan year. (Effective for plan years beginning after December 31, 2019.)

- Provides for a remedial plan amendment period until the 2022 plan year (2024 plan year for Section 414(d) governmental plans), or a later date if Treasury provides for any plan amendment required under the SECURE Act.

Important Note: To encourage the timely and accurate filing of returns and statements, and required notices, and to help improve the overall tax administration, there will be increased penalties for failure to file retirement plan returns:

- Form 5500 penalty would be modified to $250 per day, not to exceed $150,000.

- Failure to file a registration statement would incur a penalty of $10 per participant per day, not to exceed $50,000.

- Failure to file a required notification of change would result in a penalty of $10 per day, not to exceed $10,000 for any failure.

- 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.

Benefits to Individuals

On the plus side, the SECURE Act includes several provisions designed to benefit American workers and retirees.

- People who choose to work beyond traditional retirement age will be able to contribute to traditional IRAs beyond age 70½. Previous laws prevented such contributions.

- Retirees will no longer have to take required minimum distributions (RMDs) from traditional IRAs and retirement plans by April 1 following the year in which they turn 70½. The new law generally requires RMDs to begin by April 1 following the year in which they turn age 72.

- Part-time workers age 21 and older who log at least 500 hours in three consecutive years generally must be allowed to participate in company retirement plans offering a qualified cash or deferred arrangement. The previous requirement was 1,000 hours and one year of service. (The new rule applies to plan years beginning on or after January 1, 2021.)

- Workers will begin to receive annual statements from their employers estimating how much their retirement plan assets are worth, expressed as monthly income received over a lifetime. This should help workers better gauge progress toward meeting their retirement-income goals.

- New laws make it easier for employers to offer lifetime income annuities within retirement plans. Such products can help workers plan for a predictable stream of income in retirement. In addition, lifetime income investments or annuities held within a plan that discontinues such investments can be directly transferred to another retirement plan, avoiding potential surrender charges and fees that may otherwise apply.

- Individuals can now take penalty-free early withdrawals of up to $5,000 from their qualified plans and IRAs due to the birth or adoption of a child. (Regular income taxes will still apply, so new parents may want to proceed with caution.)

- Taxpayers with high medical bills may be able to deduct unreimbursed expenses that exceed 7.5% (in 2019 and 2020) of their adjusted gross income. In addition, individuals may withdraw money from their qualified retirement plans and IRAs penalty-free to cover expenses that exceed this threshold (although regular income taxes will apply). The threshold returns to 10% in

2021.

- 529 account assets can now be used to pay for student loan repayments ($10,000 lifetime maximum) and costs associated with registered apprenticeships.

- The Bipartisan American Miners Act allows in-service distributions under a pension plan or governmental section 457(b) plan at age 59 ½. (Effective for plan years that began after December 31, 2019.)

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[1]This age is based on the “age of majority,” which is determined by each U.S. state and could vary.

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SB-10003-66