



## ALERT

MAY 23, 2019

### IN THIS ALERT:

- **UPCOMING RETIREMENT PLAN LEGISLATION (SECURE ACT OF 2019 AND RESA 2019 )**

On April 2, 2019, the House Ways & Means Committee passed H.R. 1994, the Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019. The bill was passed by the House this morning almost unanimously. This bipartisan legislation is being hailed as a landmark retirement bill that will greatly expand retirement savings. In actuality the bill is comprised of a number of relatively small improvements which taken together should improve the qualified retirement plan system. Unfortunately, the pay-fors are aimed at small business and are quite punitive. Chairman Richard Neal (D-MA), Representative Ron Kind (D-WI), Ranking Member Kevin Brady (R-TX) and Representative Mike Kelly (R-PA) joined Ways & Means Committee Chairman Neal in introducing the legislation. Meanwhile on the Senate side, the Senate Finance Committee Chairman Chuck Grassley (R-IA) and Ranking Member Ron Wyden (D-OR) introduced S. 972, the Retirement Enhancement and Savings Act of 2019 (RESA) on April 1<sup>st</sup>. *These bills are largely identical and, because of their bipartisan nature and the strong support of members of Congress, appear to be on the fast track to becoming law.*

*Despite the press surrounding the SECURE Act and RESA, the SBCA is not convinced that the opportunities to increase savings introduced by these bills is worth the harm that **the revenue raising provisions in these bills will do to small businesses and their owners.** This is somewhat ironic since it appears that small business is one of the groups that the legislation is intended to assist.*

The inclusion of these penalizing revenue provisions were the result of a “deal” between key members on the Hill and the major financial institutions that believed that Multiple Employer Plans (“MEPs”) with the elimination of two negative provisions currently contained in the law, would prove to be a very attractive vehicle for small businesses. MEPs are seen as a way to expand the small business retirement plan market by reducing administrative and investment fees for small businesses by allowing them to group together (so they are treated more like one big company for pricing) and by greatly reducing their fiduciary responsibility. Interestingly, many financial companies have begun to realize that, under these bills as proposed, they may end up losing more accounts than they may gain because of the inclusion of the partial elimination of what is commonly referred to as the “stretch” IRA as one of the pay-fors. Small business owners

will know that they cannot count on the law governing required minimum distributions to remain unchanged and may decide to take the money that would have gone into the retirement plan (a portion of which would have gone to the non-owner employees) and move it out of the company and into investments that end up with more desirable tax treatment.

## Revenue Raisers

Currently, the “stretch” IRA allows the spouse of a deceased IRA owner to take money out of the IRA in installments over the spouse’s remaining lifetime. Then, to the extent there are still funds remaining in the IRA after the passing of the owner and the spouse, the funds can remain in the IRA and be taken out in installments over the lifetime of the spouse’s beneficiary(ies) – typically, the children. As a general rule, the children can take funds out faster than their life expectancy but the “prudent” child will use this money as a safety net throughout his/her lifetime. *One of the major revenue raising provisions contained in the SECURE Act would require that, in most cases, the money left by the spouse (or by the participant, if there is no spouse) to be distributed to the children (or other beneficiaries) within 10 years. The result in the vast majority of cases would be that this IRA money will be spent rather than being able to serve as a safety net for the next generation.* Financial institutions know that it is unlikely that money forced out of the IRA will stay with the institution in a taxable account, rather it is far more likely that the money will be removed and spent.

Small business owners, as a general rule, cannot rely upon selling their businesses at a profit, nor can they rely on non-qualified deferred compensation plans as top management employees can in a larger business for their retirement security. Thus the retirement plan sponsored by their own company is often their only guaranteed source of retirement income. Incentivized by tax deductions and tax free growth, owners will part with money that they could have received as additional compensation or that they could have put back into the company, by diverting it into the retirement plan where the employees must receive significant contributions in order for the owner to also receive significant contributions. Because of this dynamic, *this provision partially eliminating the stretch IRA is aimed squarely at the small business owner who has taken his/her role in providing for his/her own retirement security seriously and has in effect “outlived” his retirement account.* By forcing the money out of the IRA to the adult children (or other beneficiary who does not meet the narrow exceptions) within a 10 year period, the IRA money is converted into an undesirable asset compared to other assets that went through the deceased parents’ estates and ended up with a step up in basis. This may lead to the premature freezing or termination of plans once the owners perceive that they have saved sufficient funds in the retirement plan.

*A second revenue raising provision dramatically increases the penalties for late filing of the IRS forms for retirement plans (such as Form 5500 which is required by IRS for plans to report certain information to it every year).* It doesn’t take a rocket scientist to figure out what group of businesses will most likely be late in filing these forms and therefore paying the increased penalties – the big companies with armies of people in their accounting and benefits departments or the small businesses without in-house employee benefit experts?

So what does small business get in return for being the brunt of these harmful revenue raising provisions? The summary below only discusses the provisions that the SBCA believes could make a meaningful difference in the retirement security of a large number of people. The SECURE Act contains a number of other provisions targeted to specific groups that presumably will be helpful to that limited group.

### **Section 101. Multiple Employer Plans; Pooled Employer Plans**

The summary of this section prepared by the Congressional Research Service for the Ways and Means Committee states: “Multiple employer plans (MEPs) provide an opportunity for small employers to band together to obtain more favorable pension investment results and more efficient and less expensive management services. The legislation makes MEPs more attractive by eliminating outdated barriers to the use of MEPs and improving the quality of MEP service providers.” The legislation contains provisions which would allow a MEP to be maintained by either employers with a common interest or for employers that do not have such a nexus, by a pooled plan provider. The SECURE Act would eliminate the bad apple rule which currently provides that if, one plan in a MEP is disqualified, all of the plans in the MEP are disqualified. It is primarily due to the existence of the bad apple rule that plan advisors have cautioned their clients against going into a MEP. The SECURE Act calls for the IRS to provide a model plan which may be adopted. The language appears to shift a number of requirements to the provider of the pooled employer plan and significantly reduces the fiduciary responsibility of each small business that has joined the MEP. Obviously, a small business that wants a retirement plan tailored to its needs will not be interested in a MEP. It is possible that companies with SIMPLEs might move over to a MEP.

Our experts on our Board and Advisory Boards believe that the individual plans comprising a MEP will likely see a fee reduction for the investments offered under the MEP, but that the administrative savings will not be significant. We think the jury is out whether small businesses who have stayed out of the voluntary retirement plan system will use a MEP to get in. The statistics are clear that, under the existing framework, once a small business has more than 50 employees, it typically provides a retirement plan for its employees. *We believe it is only the smallest, newest, most unstable or unprofitable small and micro businesses which stay away from the retirement plan system. Time will tell whether these micro entities will use a MEP or continue to avoid sponsoring a retirement plan. Thus, the SBCA is not sure whether MEPs will provide the panacea that the financial institutions and Congress think they will. Given this, the SBCA is not in favor of forcing IRA money into the beneficiary's income after the passing of a participant and his/her spouse within a short period of time as a revenue raiser for this provision that may or may not work.*

### **Section 103. Simplification of Safe Harbor 401(k) Rules**

The bill would allow a plan to adopt the 401(k) safe harbor at any time up to the 30th day before the close of the plan year. [Today this election with respect to an ongoing 401(k) plan has to be made before the beginning of the plan year and with respect to a profit sharing plan 3 months before the end of the plan year.] A plan could adopt a safe harbor even after that time if the amendment provided a 4% non-elective contribution (instead of 3%) and the plan is amended no

later than the last day for distributing excess contributions for the plan year. The notice requirement for the 3% non-elective safe harbor that never made sense will be eliminated. *The SBCA is in favor of this Section and, in fact, was the driving force behind the elimination of the safe harbor notice of the 3% non-elective contribution.*

#### **Section 104. Increase Credit Limitation for Small Employer Pension Plan Start-Up Costs and Section 105. Small Employer Automatic Enrollment Credit**

This part of the bill would increase credits for small businesses adopting a plan or adopting auto enrollment which has been shown to increase participation in 401(k) plans. *The SBCA, while in favor of increasing credits, is not convinced that the credits will make a meaningful difference in the decision of most small businesses to adopt a qualified retirement plan or will be a sufficient inducement to establish an auto enrollment feature in a retirement plan.*

#### **Section 107. Repeal of Maximum Age for Traditional IRA Contributions**

The bill would allow people to continue making contributions to a “regular” IRA past the age of 70½. Of course, they still have to take out a portion of the contribution that they make under the Required Minimum Distribution rules though this legislation would slightly improve the Required Beginning Date by delaying it to age 72. See Section 114. below. *While the SBCA is in favor of this provision, we again do not believe it will significantly increase retirement savings.*

#### **Section 112. Allowing Long-term Part-time Workers to Participate in 401(k) Plans**

Except in the case of collectively bargained plans, the bill would require employers sponsoring a 401(k) plan to have, in addition to the regular one year of service requirement with the 1,000 hour of service rule, a new 3 consecutive years of service with at least 500 hours of service rule. In the case of employees who are eligible because of the new 3 year/500 hour rule, the employer is allowed to exclude such employees from testing under the nondiscrimination and coverage rules, and from the application of the top-heavy rules. This provision is designed to allow part-time employees who have worked for a company for three years to be able to make 401(k) contributions. *The SBCA is in favor of this rule but believes this new rule should be combined with the total elimination of the top-heavy rules for defined contribution plans which would do away with archaic complex rules which only small and mid-size plans have to deal with. It is important that the regulations governing this new provision be clear and not unduly burdensome to small business employers.*

#### **Section 113. Penalty-Free Withdrawals for Individuals in Case of Birth of Child or Adoption**

This provision allows a \$5,000 “qualified” birth or adoption distribution (except from defined benefit plans) without the imposition of the 10% early withdrawal tax.

#### **Section 114. Increase in Age for Required Beginning Date for Mandatory Distributions**

The bill would increase the Required Beginning Date for minimum distributions from age 70 1/2 to 72.

*The SBCA supports this change but does not believe it goes far enough. The required beginning date should be extended to age 75. This is a case where we urge that the revenue estimates be balanced against the overall needs of retirement security by people who are living far longer than when this rule was first imposed. The SBCA believes that it is high time to eliminate the discriminatory provision that requires only small business owners to start taking out distributions from the plan when they attain the age of 70 1/2, even if they are still working when all other employees do not have to take distributions out until they stop working.*

### **Section 201. Plans Adopted by Filing Due Date for Year May Be Treated as in Effect as of Close of Year**

Today a retirement plan must be adopted by the last day of a given plan year to be effective for that year. This provision of the bill would allow a plan to be adopted before the due date (including extensions) of the tax return for the taxable year to be effective to the beginning of that particular year. *The SBCA is in favor of this provision.*

### **Section 202. Combined Annual Reports for Group of Plan**

The Ways and Means summary of the SECURE Act for this section states: “The legislation 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 named 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 will reduce aggregate administrative costs, making it easier for small employers to sponsor a retirement plan and thus improving retirement savings.”

### **Section 203. Disclosure Regarding Lifetime Income**

The bill would require that benefit statements provided to defined contribution plan participants include a lifetime income disclosure at least once during any 12-month period. The disclosure would 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. The Secretary of Labor would be directed to develop a model disclosure. Disclosure in terms of monthly payments are intended to provide useful information to plan participants in correlating the funds in their defined contribution plan to lifetime income. Plan fiduciaries, plan sponsors, or other persons will have no liability under ERISA solely by reason of the provision of lifetime income stream equivalents that are derived in accordance with the assumptions and guidance under the provision and that include the explanations contained in the model disclosure.

*While the SBCA understands the goal behind this provision, the reality is that most participants want to leave any remaining plan assets after their passing to their beneficiaries in an IRA. This is because the participant and, if married, the owner’s spouse, know that their designated*



*beneficiaries will receive the amounts left in the IRA after their deaths and that they will not be forfeited back to another entity. Thus, this is likely to end up another paragraph in a form that most participants will not take the time to read. Despite Congress' and Treasury's belief that most employees are reading the voluminous forms that businesses are required to hand out to their plan participants, very few even retain the forms, let alone read them. Every effort should be made to make this provision as least burdensome as possible for small businesses.*

#### **Section 204. Fiduciary Safe Harbor for Selection of Lifetime Income Provider**

Under the bill, fiduciaries are afforded an optional safe harbor to satisfy the prudence requirement with respect to the selection of insurers for a guaranteed retirement income contract 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. *This is a provision that the SBCA has supported for years.*

#### **Section 302. Expansion of Section 529 Plans**

Tax-free distributions will be allowed for apprenticeship expenses and student loan repayments up to \$10,000. This provision would be applicable to distributions made after December 31, 2018. This provision was just amended in the last few days.

#### **Section 401. Modifications to Required Minimum Distribution Rules**

**As mentioned above, this pay-for provision is intended to destroy the stretch IRA that is primarily used by parents to provide a safety net for their children by allowing the children to take out distributions over their life expectancies from whatever IRA money is remaining in the surviving parent's IRA upon his/her death.** This revenue raising provision would require in the vast majority of cases that the children have to take out all of the money remaining in the IRA within 10 years after the passing of the last surviving parent. Experts in this area know that many children take out the money earlier than required and basically spend it, but there are children who listen to their parents and to the pundits who have taught them to save early and as much as possible and these children would have used this money as a safety net having required minimum distributions paid out over their lifetimes. Exceptions to the 10 year rule are made for "eligible beneficiaries" who as of the date of death of the participant or IRA owner is a spouse, is disabled, is chronically ill, is an individual who is not more than 10 years younger than the participant or IRA owner, or is child of the participant or IRA owner who has not reached the age of majority and then the 10 year rule is applied to such child. This provision is effective for defined contribution plans (note this provision is not applicable to defined benefit plans) and IRAs that are not collectively bargained or governmental plans with respect to plan participants or IRA owners with a date of death after 12/31/19.

**This is in effect a significant retroactive change in the law with no grandfathering for account balances accumulated in the plan prior to this date.** If instead of 10 years, the account balance was forced into the income of the beneficiaries over 15 years, the SBCA believes that small business owners would not be likely to stop saving in their retirement plans

when the account gets to a point that they think they may not be able to spend over their lifetimes. This will avoid small business plans being frozen or terminated prematurely.

RESA has a different provision for modifying the required minimum distribution rules under its Section 501. This provision allows the normal required minimum distribution rules (i.e., distributions can be made over the lifetime of the beneficiary) for the first \$400,000 of retirement plan assets received by each beneficiary. For amounts over the \$400,000 amount, the account is forced into the beneficiary's income over a 5 year period. Apparently, this provision is seen as unwieldy by the financial institutions making the SECURE provision the more likely one to emerge.

**The SBCA would prefer either merging the SECURE and RESA provisions so that the first \$400,000 per beneficiary remains under existing law and then amounts in excess are forced into the beneficiary's income over 10 years, or probably better and simpler that all amounts are forced into income over 15 years.**

*The SBCA strongly opposes both of these provisions as currently drafted and believe them to be unfair and harmful to small business owners.*

### **Section 403. Increased Penalties for Failure to File Retirement Plan Returns**

As mentioned above, this provision *dramatically* increases the failure to file penalties for retirement plan returns. A recent amendment to this legislation would modify the Form 5500 penalty to \$250 per day (up from \$25 today), not to exceed \$150,000 (up from \$15,000 today). Failure to file a registration statement would incur a penalty of \$10 per participant per day (presently \$1), not to exceed \$50,000 (presently \$5,000). Failure to file a required notification of change would result in a penalty of \$10 per day (presently \$1), not to exceed \$10,000 (presently \$1,000) 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. The reason given for this change in the Ways and Means Summary for this change is "Increasing the penalties will encourage the filing of timely and accurate information returns and statements and the provision of required notices, which, in turn, will improve overall tax administration." **The reason behind this legislation would be somewhat comical except that the companies who will have to pay all of these increased penalties will likely be small businesses who have the least amount of resources to pay these increased fees and will in most cases reduce contributions to all of their employees in a following year to make up for these costs.** Congress seems to forget that most small business owners are people who spend the vast majority of their time running their businesses.

*The SBCA strongly opposes this provision.*

### **Conclusion**

Most observers believe these bills will emerge in the final legislation very close to what is set forth above. Interestingly, most of the major financial and ERISA groups have come out in favor of this legislation, which from our perspective is somewhat puzzling given the detrimental

impact the revenue raising provisions will have on small businesses and the negative impact on financial institutions that sponsor IRAs. It is still not too late to let your representatives know your thoughts on this legislation.

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