THE SMALL BUSINESS LEGISLATIVE COUNCIL ALERT

2019: 5 **MAY 24, 2019**

IN THIS ALERT:

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

On May 24, 2019, the House passed H.R. 1994, the **Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019 in a 417 to 3 vote**. 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 punitive pay-fors are aimed squarely at small business.

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 1st.

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. Look for a vote in the Senate in the next week or two.

*Despite the press surrounding the SECURE Act and RESA, the opportunities to increase savings do not seem to offset the harm that **the revenue raising provisions in these bills can 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.*

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. 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) be distributed to the children (or other beneficiaries) **within 10 years, rather than being taken over their life expectancies**. The result in the vast majority of cases would be that this IRA money is likely to be spent rather than being able to serve as a safety net for the next generation*.

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). See the description under Section 4.03. below. 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 are likely to 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 official summary of this section 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. **This section of the bill also 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.

Most retirement plan experts agree that the individual plans comprising a MEP will likely see a fee reduction for the investments offered under the MEP, but many of those experts do not agree that there will be significant administrative savings. 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. *As a general rule, 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, it is not clear whether MEPs will provide the panacea that the financial institutions and Congress think they will.*

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. *These are favorable provisions. The optional 401(k) safe harbors are popular with small business retirement plans because once the required contribution is made there is no 401(k) discrimination testing which means all employees, including the highly compensated employees, can contribute the maximum amount to the 401(k) plan in any given year.*

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. *These are favorable provisions. Whether the credits will make a meaningful difference in the decision of many small businesses to adopt a qualified* *retirement plan or will be a sufficient inducement to establish an auto enrollment feature in a retirement plan, which can complicate plan administration, remains to be seen.*

Section 107. Repeal of Maximum Age for Traditional IRA Contributions

The bill would allow people to continue to make 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.

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.** This provision would have been more attractive if it had been combined with a repeal of the complex and unnecessary top heavy rules which only apply to small and mid-size plans. *Hopefully, the regulations governing this new provision will 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.

This is a favorable provision but does not go far enough - age 75 would have made more sense given the longevity being enjoyed by so many people. *The revenue estimates should be balanced against the overall needs of retirement security by people who are living far longer than when this rule was first imposed. Also, this Section of the bill should have* ***eliminated the discriminatory provision that requires <u>only</u> small business owners to take out distributions from the plan when they attain the age of 70 ½ (soon to be 72), 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. *This is a favorable provision since it will allow small business owners more time to decide if they should adopt a plan in a given year.*

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.

The goal behind this provision is to have more plan participants elect annuities, rather than lump sum payments. However, most participants want to take a lump sum distribution from the plan and roll it into 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 as is often the case with annuities to the entity that provided the annuity.

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 read them before tossing them in the closest trash can. It is important that ***every effort 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 favorable provision.*

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. *This is a favorable provision.*

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 a child of the participant or IRA owner who has not reached the age of majority. Once the child reaches the age of majority 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.

Small business owners generally cannot rely upon selling their businesses at a profit, nor can they generally rely upon 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 into the taxable income of the adult children (or other beneficiary who does not meet the narrow exceptions set forth above) within a 10 year period, the IRA money is converted into an undesirable asset compared to other assets that went through the estates of the deceased participant or IRA owner and spouse, if married, and ended up with a step up in basis or was placed in a vehicle which would escape estate taxation. 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.

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 impact of this provision would be significantly lessened.

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 (money forced out of the IRA within 10 years) the more likely one to emerge.

This is a very unfavorable provision 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 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." **This reason 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 and not administering their employee benefit plans.

This is a very unfavorable provision for small business and means that small business will be providing the lion's share of revenue for this bill.

Conclusion

Most observers believe these bills will emerge in the final legislation very close to what is set forth above. Interestingly, the US Chamber and most of the major financial and ERISA groups have come out in favor of this legislation, which is somewhat puzzling given the detrimental impact the revenue raising provisions will have on small businesses.

UPCOMING EVENTS

2019 Legislative meetings:

June 4, 2019 - ICBA offices – 1615 L Street, NW, Suite 900 – RSVP to Kathy Glenn at kglenn@paleyrothman.com

August 15, 2019 – Conference Call

October 1, 2019 - ICBA offices – 1615 L Street, NW, Suite 900

All meetings run from 10:00 AM to 12:00 noon

Retreat Dates and Details to be Announced Soon – Spoiler - our Chair, Corey Rosenbusch, has put together a terrific package!