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Year-end tax act ushers in retirement plan changes, Cadillac health tax repeal, and more

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As part of a year-end appropriations measure to keep the federal government funded through September 2020, the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act) became law on December 20, 2019. The SECURE Act implements a number of mandatory and optional changes for employer-sponsored benefit plans. **Many of these changes become effective currently or in the next year, and some even have a retroactive effect that would require retirement plan sponsors' immediate attention.**

Although the majority of the changes apply to retirement plans, the 2020 appropriations act also brings change for employer-sponsored health and welfare plans. A particularly welcome development is the repeal of the Cadillac tax on high-cost medical plans. For retirement plans, the SECURE Act pushes the mandatory distribution commencement rule to age 72, puts defined contribution and defined benefit plans on par by allowing in-service withdrawals at age 59½ encourages new multiple-employer defined contribution plans and "pooled employer plans," and increases flexibility for safe harbor 401(k) plans, among other changes.

The following summary gives a brief overview of some of the most notable changes to retirement and welfare plans that employers should know in putting together their to-do lists. Although we are yet to hear from the IRS on the timing of amendments to retirement plans that must reflect the SECURE Act changes, employers should start reviewing their plans now to determine what action is immediately required under the new legislation, and what steps must be taken to ensure plan compliance in 2020 and beyond.

Retirement plan changes

Required beginning date increased to age 72

To reflect increased life expectancies and fortify retirement savings, the SECURE Act pushes the age at which retirees must start drawing on their plan savings to age 72 (currently 70½). Thus, participants in qualified plans and 403(b) plans would have to start distributions by April 1 following the later of the year of their retirement or the year in which they reach 72. (The required beginning date for certain 5% owners is the April 1 following the year in which they attain age 72, even if they have not retired.) The change applies prospectively to distributions required to be taken after December 31, 2019, by individuals who attain age 70½ after December 31, 2019. **Plans will still have to start distributions by April 1 of 2020 for those who reach age** 70½ **in 2019 and continue distributions for those who reached age** 70½ **in an earlier year.**

Revamping post-death distribution rules

For defined contribution plan participants who die after December 31, 2019 (a special effective date may apply to certain collectively bargained and governmental plans), the SECURE Act now requires the participant's entire account balance to be distributed within ten years following the participant's date of death (this change also applies to Individual Retirement Accounts). This rule replaces the previous five-year rule and, in part, the life expectancy rule for defined contribution plans. The new ten-year distribution period applies regardless of whether the participant died before, on, or after the required beginning date (now, age 72). The SECURE Act allows, however, the account balance to be distributed over the life or life expectancy of certain "eligible designated beneficiaries," defined to include the employee's surviving spouse, a child who has not reached the age of majority, a chronically ill individual, or an individual not more than ten years younger than the employee. Following the death of the eligible designated beneficiary, the entire account balance must be distributed within ten years of the eligible designated beneficiary's death.

Similarly, once a minor child beneficiary reaches the age of majority, the account balance must be distributed within ten years. A special rule applies to participants who die before the effective date of this new provision and whose eligible designated beneficiaries die after that date. **Plan sponsors should be on a lookout for IRS guidance and consult with their ERISA counsel on the potential impact of these rules on their plans.**

Allowing in-service pension plan distributions at 59½

Pension plans and governmental plans can now permit in-service distributions as early as age 59½ (decreased from age 62 for pension plans and age 70½ for governmental plans). This change applies for plan years beginning after December 31, 2019. **Sponsors of pension plans and governmental plans wishing to take advantage of the new law will need to change their operations and amend their plan documents accordingly**.

Plan access for part-time employees

Under prior law, employers could exclude part-time employees from retirement plan eligibility until they complete one year of service during which they work at least 1,000 hours. For plan years beginning after December 31, 2020, the SECURE Act will require employers to allow employees who work at least 500 hours per year for the last three consecutive years to make elective deferrals to the plan (subject to the age 21 limitation). The 500-hour employees need not be included in plan nonelective and/or matching contributions and can be excluded from nondiscrimination and top-heavy testing. Once these employees are included in the matching and/or nonelective contribution eligibility, the plan must credit them with a year of vesting service for each year they complete at least 500 hours.

Similarly, 500-hour employees do not need to be included in nondiscrimination safe harbors (such as automatic enrollment features), but if they are included, their contributions must be made at the default rate. Plans must start complying with the new rule for part-time employees for plan years that begin after 2020. However, 12-month periods beginning before January 1, 2021, are not taken into account for purposes of the three-year period described above. **As a result, the earliest a**

401(k) plan will be required to allow long-term, part-time employees to make elective contributions will be the 2024 plan year.

Increase in the Qualified Automatic Contribution Arrangement (QACA) auto deferral limit to 15%

For 401(k) plans that have adopted a qualified automatic enrollment feature, the SECURE Act increases the maximum permissible default rate from 10% to 15% for plan years beginning after December 31, 2019. The new 15% automatic enrollment maximum default rate can only apply during plan years following the participant's first year of participation in the plan. **Employers who employ robust savings strategies for their employees may find this increase a welcome change. They would, of course, need to start working with their vendors to develop systems that can accommodate the new law.**

Increasing flexibility for nonelective contribution safe harbor 401(k) plans

For plan years beginning after December 31, 2019, sponsors of nonelective contribution safe harbor 401(k) plans (which must provide a vested employer nonelective contribution of at least 3% of compensation) will no longer have to provide the safe harbor notice. Under the SECURE Act, employers may also adopt an amendment establishing a nonelective contribution safe harbor design for a given plan year as late as the 30th day before the end of that plan year (e.g., by December 1 for a calendar year plan). Moreover, plan sponsors may adopt a nonelective contribution safe harbor design amendment for a plan year by the last day for distributing excess contributions for that plan year (generally, by the end of the following plan year) so long as the nonelective contribution equals at least 4% of compensation. **For existing nonelective contributions safe harbor plans, the safe harbor notice is no longer required for plan years beginning on or after January 1, 2020. Employers wishing to adopt a nonelective safe harbor feature for a given plan year will now have more flexibility in making their decisions and adopting corresponding amendments.**

Prohibiting credit card plan loans

Some qualified plans previously allowed participants to access plan loans through a credit card. Effective for loans processed on or after December 20, 2019, the SECURE Act prohibits plan loans from being made through a credit card or "similar arrangement." The intent behind the prohibition is to minimize the use of plan loans to pay for routine expenses, which can accumulate over time and result in large loan balances that are difficult to pay back. Loans processed through a credit card on or after December 20, 2019, will be treated as a taxable distribution. **Plan sponsors that use credit card loans must immediately cease their current practice.**

New childbirth and adoption in-service distributions

Sponsors of defined contribution plans can amend their plans to allow participants to withdraw up to $5,000 as a birth or adoption distribution after December 31, 2019. The new SECURE Act childbirth and adoption distribution feature applies only to defined contribution plans. The $5,000 individual limit applies on a controlled group basis, requiring employer groups with multiple retirement plans to administer the limit across all plans. In order to qualify as a birth or adoption distribution, the distribution must be made during the one-year period following the date on which the child of the participant is born or on which the legal adoption is finalized. The SECURE Act allows participants to repay the birth or adoption distribution to the plan under certain circumstances. **Plan sponsors should weigh the pros and cons of allowing participants to gain early access to their retirement accounts against their long-term savings potential.**

New plan adoption by tax return due date

For tax years beginning after December 31, 2019, the SECURE Act permits employers to adopt a new qualified retirement plan for a taxable year after the close of that year if the plan is adopted before the deadline for filing the employer's tax return for that year. The plan that the employer adopts in this manner will be treated as having been adopted as of the last day of the plan year. **This rule does not alter the requirement for having a written plan document in place before employees can make elective deferral contributions.**

Changes specifically affecting 403(b) plans

The SECURE Act directs the IRS, in the next six months, to issue guidance that would provide 403(b) plans held in custodial accounts a pathway for distributing assets upon plan termination. Currently, 403(b) plans may not distribute their assets other than upon the employee's death, termination of employment, attainment of age 59½, disability, or hardship. The forthcoming guidance would permit a terminated 403(b) plan to distribute participant custodial accounts in-kind to participants to be held in a tax-deferred 403(b) custodial account until the account balance is paid out. For accounts to be considered distributed, the employer must discontinue material involvement with the accounts. However, these accounts will not be considered employer-sponsored plans merely because they were first established as a group contract. The expected guidance will be effective retroactively to tax years beginning after December 31, 2008.

Special rules apply to 403(b) retirement income accounts that a church or church-controlled organization is permitted to have. The SECURE Act clarifies those retirement income accounts can cover certain employees of tax-exempt organizations that are controlled by or associated with a church or an association or convention of churches (effective for plan years beginning on or after December 20, 2019).

Changes affecting Form 5500 reporting

Increased retirement plan reporting penalties under the tax code

Retirement plans that fail to file a required Form 5500 will now be subject to a $250 per day penalty (previously, $25) under the Internal Revenue Code, capped at $150,000 per year. In addition, a failure to file the required Form SSA registration statement for participants with a vested benefit who did not receive payment during the year results in a civil penalty of $10 per day for each participant with respect to whom the failure applies, up to a maximum penalty of $50,000 per year. Lastly, failure to notify the IRS regarding a change in the name of the plan, the name or address of the plan administrator, plan termination, or merger or consolidation of the plan with any other plan or its division into two or more plans results in a penalty of $10 per day, up to a maximum of $10,000 for each failure. These penalties may be waived if the failure to file is due to reasonable cause. **For returns due after December 31, 2019, plan sponsors and plan administrators must take note of the increased penalties and ramp up their reporting procedures. Note that these are tax penalties. The SECURE Act has not changed reporting penalties that the Department of Labor (DOL) may assess under ERISA.**

Consolidated form 5500 filing option for plans of unrelated employers

For plan years beginning after December 31, 2021, defined contribution plans maintained by unrelated employers may file a single Form 5500 if the plans have the same trustee, the same-named fiduciary or fiduciaries, the same administrator, the same plan year, and provide the same investments or investment options to participants and beneficiaries. **The IRS and DOL will implement changes to Form 5500 no later than January 1, 2022, to allow a consolidated filing. The new opportunity is particularly useful to PEOs and associations of small employers who share consolidated plan administration. However, the requirement to have the same investment option may prove to be a hindrance.**

Simplified reporting for small multiple-employer plans

For plan years beginning after December 31, 2020, the DOL may, by regulation, permit simplified reporting for a multiple-employer plan with fewer than 1,000 participants, provided that each participating employer has fewer than 100 participants.

Changes affecting multiple-employer plans

The end of "one bad apple" rule

Employers participating in multiple-employer plans will be able to breathe easier once the SECURE Act provision eliminating the "one bad apple" rule springs into life for plan years beginning after December 31, 2020. The new rule will apply to multiple-employer plans sponsored by employers that have a common interest besides their adoption of the plan and to newly minted "pooled employer plans." The SECURE Act ensures that one participating employer's qualification failure would not cause all other employers participating in the multiple-employer or pooled employer plan to be held liable or lose their tax-favored status under the plan. The relief from disqualification is conditioned on the plan provisions that would require a transfer of the offending employer's plan assets to a plan solely of that employer, to an eligible retirement plan (including an IRA) for each participant, or to such other vehicle as the Secretary of the Treasury may prescribe. The Secretary may also determine that it may be in the best interests of the participants to retain the tainted assets in the multiple-employer or pooled employer plan. The offending employer must remain responsible for all liability arising from the qualification failures. The Secretary may also provide whether a failure by a pooled plan provider must result in the disqualification of the entire plan.

Pooled employer plans

The SECURE Act creates a new type of multiple-employer retirement plan (referred to as a "pooled employer plan"), which allows unrelated employers to establish a single ERISA plan for plan years beginning after December 31, 2020. Pooled employer plans allow employers that do not have a common interest to come together to offer their employees a retirement plan. These plans must have a common "pooled plan provider." The terms of the plan must designate the pooled plan provider as the named fiduciary and plan administrator, and the provider must acknowledge its named fiduciary status and register with the Secretary of the Treasury. The SECURE Act directs the Secretary to issue regulations implementing the pooled plan provider requirements. Before the regulations are issued, employers may comply with the new requirements in good faith. The SECURE Act provides that each employer participating in the pooled employer plan shall be treated as the plan sponsor with respect to the portion of the plan attributable to employees of the employer. Special Form 5500 rules will apply to a pooled employer plan, including identifying information for the pooled plan provider, a list of employers participating in the plan, a good faith estimate of the percentage of total contributions made by each employer to the plan during the plan year, and the aggregate account balances attributable to each employer in the plan. **Unrelated employers seeking to establish a pooled employer plan beginning in plan years on or after January 1, 2021 should stay tuned for model language from the IRS that can be adopted to establish a pooled employer plan.**

Retirement plan lifetime income requirements

Disclosure of lifetime income estimates

At least once annually, the SECURE Act requires defined contribution plans to provide an estimate of the monthly payments a participant would receive if a qualified joint and survivor annuity for the participant and the participant's surviving spouse (if applicable) or a single life annuity were elected. Plan sponsors and fiduciaries will not be liable for information provided in the estimates, as long as the estimates include certain assumptions and explanations included in a model notice that will be issued by the DOL. **Plan sponsors should stay tuned for the DOL model disclosure. The annual disclosure requirement will go into effect twelve months after the latest of the DOL's publication of an interim final disclosure rule model disclosures or assumptions.**

Safe harbor for plan fiduciary selection of annuity provider

The SECURE Act expands upon a prior DOL annuity selection safe harbor and provides a safe harbor for plan fiduciaries who select a provider of a guaranteed retirement income contract. This is an optional safe harbor that is available for guaranteed retirement income contracts only. A "guaranteed retirement income contract" means an annuity contract for a fixed term or providing for guaranteed annual or more frequent payments for the life, life expectancy or joint lives or life expectancies of a participant and beneficiary. A plan fiduciary would generally be deemed to have acted prudently in selecting such a provider if the fiduciary engages in an objective, thorough, and analytical search for the appropriate annuity provider considers the cost and benefit features of the contract, obtains written assurances from the provider that the provider has satisfied specific requirements, including applicable state insurance laws, and as a result of the foregoing analysis concludes that the issuer is financially capable of satisfying its obligation and the cost of the contract is reasonable. The Act specifically provides that a fiduciary is not required to pick the lowest cost contract provider. **The safe harbor applies to guaranteed retirement income contract providers selected on or after December 20, 2019. Fiduciaries of plans that offer guaranteed retirement income distribution options who wish to take advantage of this safe harbor should familiarize themselves with the statutory requirements and work with their advisors during the selection process.**

Portability of discontinued lifetime annuity options

Effective for plan years beginning after December 31, 2019, the SECURE Act allows defined contribution, 403(b), and governmental 457(b) plan participants to elect direct trustee-to-trustee transfers, or distributions to effectuate a transfer, of lifetime income options that are removed as investment options under a plan. The transfer may occur on or after the date that is 90 days before the lifetime income option is eliminated by the plan. **Plan sponsors that offer lifetime annuity options may want to consider whether to permit qualified distributions of these investments once they cease to be available under the plan.**

Defined benefit plan changes

Automatic nondiscrimination relief for frozen plans

In a long-awaited step, the SECURE Act provides non-discrimination relief with respect to frozen defined benefit plans that provide benefits to longer service, older employees, provided certain requirements are met. **The relief applies only to certain closed plans and classes of participants. Sponsors of closed defined benefit plans should consult a qualified ERISA counsel to determine whether and how they may avail themselves of the nondiscrimination relief**.

Health and welfare plan changes

Repeal of Cadillac tax

The SECURE Act repeals the Cadillac tax slated to go into effect in 2022, providing welcome relief to employers and industry stakeholders that have been lobbying for repeal of the tax for several years. The Cadillac tax would have resulted in a tax equal to a 40% excise tax on the value of "high-cost" employer-sponsored health coverage.

Repeal of tax on health insurance providers Health ("Health Insurance Tax" or "HIT")

The SECURE Act also repealed the HIT tax beginning with calendar year 2021—the HIT tax will remain in effect for 2020 following a moratorium in 2019. Repeal of the HIT tax is especially welcome to fully-insured employer group health plans, which bore the brunt of the tax in the form of increased premium costs passed on by insurance carriers.

The paragraphs above provide a brief overview of only select provisions of the 2020 spending bill and are not intended to provide an exhaustive summary or analysis of the law. Employers who wish to learn more about the new law and its impact on their retirement and welfare plans are welcome to contact your Nixon Peabody attorney, a member of the employee benefits team, or the authors of this article:

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