

# UNDERSTANDING THE SECURE ACT WHAT IT COULD MEAN FOR YOU

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# PRESENTATION OVERVIEW

- Overall impact of the Secure Act
- MEPs – multiple employer plan
- Required Beginning Date pushed back to 72
- More time to adopt a 401(k) safe harbor
- Part-time employees allowed to make 401(k) contributions

# PRESENTATION OVERVIEW

- Retirement plans allowed to be adopted up to due date of tax return
- Annual estimate of annuity that account will provide
- Credit for new plan startup increased
- New credit for auto enrollment added to small plan

# PRESENTATION OVERVIEW

- New safe harbor for fiduciary liability in selection of annuity provider
- Significant increases for penalties for failure to file Form 5500
- Tax advantages of a stretch IRA
- SECURE Act eliminates the stretch IRA for most non-spousal beneficiaries – who is exempt?
- Ways to minimize impact of loss of the stretch

# OVERALL IMPACT OF THE SECURE ACT

- Most retirement plan changes are minor – some will be helpful – others will cause more work for small plans
- One change that should prove to be important is the open multiple employer plan known as a MEP
- Most significant change for those who already have saved for their retirement is the elimination of the stretch IRA

# MEPS – MULTIPLE EMPLOYER PLANS

- **The concept of a MEP or pooled provider plan is that a group of plans will band together and by doing so will enjoy lower plan administration costs, lower investment fees in mutual funds investments, reduced fiduciary responsibility and will no longer be burdened with filing annual IRS forms.**

# MEPS

- The SECURE Act removed two major roadblocks which in the past kept small businesses away from joining MEPs. Plan administrators have cast doubts on the ability of a MEP to reduce administrative fees, but it appears the other advantages will prove to be significant.
- What is not clear is how much flexibility with respect to investments and plan design an employer will have to give up to join a MEP.



# MEPS

- Some contend that while MEPs may not attract significant numbers of new plans, they are likely to attract a number of existing retirement plans from companies eager to reduce fees, fiduciary liability and some administrative burdens. **It is anticipated that many insurance companies, brokerage houses and associations will set up MEPs.**



## REQUIRED BEGINNING DATE (RBD) FOR REQUIRED MINIMUM DISTRIBUTIONS (RMDs) MOVED BACK FROM 70 ½ TO 72

- Effective for distributions required to be made after 12/31/19, the Required Beginning Date is moved back from age 70 ½ to 72, *but only for individuals who attain age 70 ½ after that date*
- For those born before July 1, 1949, the old RBD of age 70 ½ applies
- No relief for those who attained age 70 ½ before 12/31/19

# SAFE HARBOR 401(K) PLAN CHANGES

- Safe harbor 401(k) plans provide either a 3% nonelective contribution or an employer match thereby allowing all highly compensated employees to make the maximum 401(k) contribution regardless of what the non-highly compensated employees contribute to the plan

# SAFE HARBOR 401(K) PLAN CHANGES

- For plan years beginning after December 31, 2019, **the annual safe harbor notice for the 401(k) nonelective safe harbor (this is the 401(k) safe harbor that requires a 3% employer contribution) is eliminated.** The notice is still required for a safe harbor matching contribution

# SAFE HARBOR 401(K) PLAN CHANGES

- For plan years beginning after December 31, 2019, companies can safe harbor a 401(k) plan before the 30<sup>th</sup> day before the close of the plan year. This means a company can determine if the plan is going to fail 401(k) testing, then up to 30 days before the end of the plan year it can adopt the 3% nonelective safe harbor and retroactively have the safe harbor rules apply to the beginning of the year.

# SAFE HARBOR 401(K) PLAN CHANGES

- Companies can now monitor 401(k) contributions going into the plan during the year and adopt the safe harbor provision only if needed. **Even up until the end of the following plan year, the company can retroactively adopt the safe harbor provisions - but the 3% safe harbor contribution must be increased to 4%.**
- This is a very positive change for small plans

## 401(K) MUST ALLOW LONG TERM EMPLOYEES WHO WORK MORE THAN 500 HOURS BUT LESS THAN 1000 PER YEAR TO PARTICIPATE

- Starting in 2024, 401(k) plans must allow part-time employees (those who work more than 500 hours but less than 1000 over 3 consecutive years) to make 401(k) contributions
- No employer contributions will be required (at least not yet!)

## 401(K) MUST ALLOW LONG TERM EMPLOYEES WHO WORK MORE THAN 500 HOURS BUT LESS THAN 1000 PER YEAR TO PARTICIPATE

- Companies will need to begin tracking hours of service for part-time employees for plan years beginning after 12/31/20, so participation is delayed until plan year 2024
- Question – can a company start allowing 401(k) contributions for part-time employees or in order to not trigger top-heavy or safe harbor contributions and not be subject to anti-discrimination testing, must the company wait until 2024?



## RETIREMENT PLANS ADOPTED BY FILING DUE DATE FOR YEAR CAN BE TREATED AS IN EFFECT FOR THAT YEAR

- Companies can treat a profit sharing, pension, stock bonus or annuity plan that is adopted after the close of the taxable year, but before the due date (including extensions) of the tax return, as having been adopted as of the last day of the taxable year
- Effective for taxable years beginning after 12/31/19
- This may prove very helpful for small businesses where companies determine excess profits after the close of the fiscal year end





## RETIREMENT PLANS ADOPTED BY FILING DUE DATE FOR YEAR CAN BE TREATED AS IN EFFECT FOR THAT YEAR

- The old rule is that a plan had to be adopted by the end of the fiscal year in order to have an effective date retroactive to the beginning of that year
- This new provision gives companies more time to decide to adopt the plan. Note this cannot apply to 401(k) plans.

# NEW DISCLOSURE REGARDING LIFETIME INCOME OPTIONS

- Annual notices to plan participants in profit sharing, 401(k) or other defined contribution plans will need to include the monthly payments he/she would receive as a single life and a joint and survivor annuity if annuity option had been selected
- **DOL has to issue a model disclosure and the assumptions that the plans must use to come up with the annuity values within a year of enactment.** This provision is effective 12 months after the release of the DOL guidance.

# NEW DISCLOSURE REGARDING LIFETIME INCOME OPTIONS

- This applies even to plans without an annuity option
- At this point, no minimum account balance for which the disclosure is not required. Hard to believe that a plan would have to show the value of a joint and survivor annuity that a \$1000 account would purchase (the real answer is that it couldn't!)

## SMALL EMPLOYER PENSION PLAN STARTUP CREDIT INCREASE AUTO ENROLLMENT CREDIT

- SECURE Act increases the startup credit for small employers to the lesser of 1) 50% of startup costs or 2) the greater of (i) \$500 or (ii) the lesser of \$5,000 or \$250 x number of non-highly compensated employees eligible to participate in the plan
- Small employers that adopt an automatic enrollment feature are eligible for a new \$500 income tax credit for 3 years
- Small employers = 100 employees or less

# FIDUCIARY SAFE HARBOR FOR SELECTION OF ANNUITY PROVIDER

- Effective immediately, there is a new safe harbor intended to provide relief from the fiduciary liability involved in the selection of an annuity provider for participants who elect an annuity payout option
- Many plans will want to wait for guidance from IRS before trying to fit within the safe harbor

# INCREASED PENALTIES FOR FAILURE TO FILE RETIREMENT PLAN FORMS

- A number of penalties were increased but the most likely penalty to hit small businesses will be failure to file 5500
- Before the SECURE Act the penalty was \$25 a day up to a maximum penalty of \$15k per plan year – now penalty is up to \$250 a day up to maximum penalty of \$150,000 per plan year!



# INCREASED PENALTIES FOR FAILURE TO FILE RETIREMENT PLAN FORMS

- DOL still has authority to assess penalties with the penalty for a late filer being \$2,194 per day (adjusted for inflation!) *with no maximum*
- Correction under DOL's Delinquent Filer Voluntary Compliance Program (DFVCP) now even more important (if done correctly, penalties drop to \$10 per day with a max of \$2k for one late form and \$4k for multiple years and IRS penalties waived)



# TAX ADVANTAGES OF A STRETCH IRA

- A stretch IRA is an IRA that is set up so that payments can be made over the life expectancy of a beneficiary (ben)
- When a ben takes out all \$\$ from IRA in one year (lump sum distribution) about 50% is lost to federal (and state, if applicable) taxes



# TAX ADVANTAGES OF A STRETCH IRA

- When a ben takes out the minimum amount required by law (RMDs) then only that annual distribution is subject to income taxes, the rest of the IRA continues to grow tax free
- When the earnings in the IRA are greater than the RMD, then tax free compounding

# TAX ADVANTAGES OF A STRETCH IRA

- The impact of tax free compounding increases with the amount of time that the funds stay in the IRA
- If a 50 year old ben with a \$1m IRA took out only RMDs over his/her 34.2 year life expectancy, and IRA earned a steady 6%, total amount received by the ben would be roughly \$3,380,000

# EXAMPLE OF RMDs FOR 50 YEAR OLD BENEFICIARY PRIOR TO THE SECURE ACT

## 50 YEAR OLD BENEFICIARY - PRIOR LAW

AGE	BOY	6%	RMD	EOY	FACTOR
	BALANCE	INTEREST		BALANCE	
50	\$1,000,000	\$60,000	\$29,240	\$1,030,760	34.2
51	\$1,030,760	\$61,846	\$31,047	\$1,061,559	33.2
52	\$1,061,559	\$63,694	\$32,968	\$1,092,285	32.2
53	\$1,092,285	\$65,537	\$35,009	\$1,122,813	31.2
54	\$1,122,813	\$67,369	\$37,179	\$1,153,002	30.2
55	\$1,153,002	\$69,180	\$39,486	\$1,182,696	29.2
56	\$1,182,696	\$70,962	\$41,940	\$1,211,718	28.2
57	\$1,211,718	\$72,703	\$44,548	\$1,239,873	27.2
58	\$1,239,873	\$74,392	\$47,323	\$1,266,942	26.2
59	\$1,266,942	\$76,017	\$50,275	\$1,292,683	25.2
60	\$1,292,683	\$77,561	\$53,417	\$1,316,827	24.2

# EXAMPLE OF RMDS FOR 50 YEAR OLD BENEFICIARY PRIOR TO THE SECURE ACT

## 50 YEAR OLD BENEFICIARY - PRIOR LAW

AGE	BOY BALANCE	6% INTEREST	RMD	EOY BALANCE	FACTOR
74	\$1,295,593	\$77,736	\$127,019	\$1,246,310	10.2
75	\$1,246,310	\$74,779	\$135,468	\$1,185,620	9.2
76	\$1,185,620	\$71,137	\$144,588	\$1,112,169	8.2
77	\$1,112,169	\$66,730	\$154,468	\$1,024,431	7.2
78	\$1,024,431	\$61,466	\$165,231	\$920,666	6.2
79	\$920,666	\$55,240	\$177,051	\$798,855	5.2
80	\$798,855	\$47,931	\$190,204	\$656,583	4.2
81	\$656,583	\$39,395	\$205,182	\$490,796	3.2
82	\$490,796	\$29,448	\$223,089	\$297,154	2.2
83	\$297,154	\$17,829	\$247,629	\$67,355	1.2
84	\$67,355	\$4,041	\$71,396	\$0	0.2

# TAX ADVANTAGES OF A STRETCH IRA BEFORE SECURE ACT

- A 35 year old beneficiary (48.5 life expectancy determined by IRS single life expectancy table) with a \$1m IRA, earning 6% interest, would have received a total amount of roughly \$6,045,000 (before taxes) from the IRA
- If the ben died at 73, (10 years before life expectancy) IRA would be worth about \$2,090,000, then payments can continue to be made for the remaining 10 years to next ben (if not older than first ben)

# TAX FREE COMPOUNDING

- With a decent rate of investment earnings the amount of the RMD for many years (for a 35 year old for 36 years - for a 50 year old for 17 years) will be smaller than the amount of earnings so there will still be tax free compounding and distributions will be coming out of earnings not principal

# WHAT IS A “TYPICAL” BEN DESIGNATION FOR AN IRA?

- Plan Participant rolls over his/her account balance to an IRA
- IRA owner (let's say husband or H) names spouse as beneficiary
- When H passes away, wife “assumes” the IRA or becomes the owner of the IRA (instead of keeping it as an “inherited” IRA)

# WHAT IS A “TYPICAL” BEN DESIGNATION FOR A SURVIVING SPOUSE?

- Wife (W) names children and/or grandchildren as the beneficiaries – W’s RMDs are based on the IRS “uniform table” – W’s life expectancy plus a hypothetical person who is 10 years younger with both lives recalculated
- When W passes away, under law prior to SECURE Act if ben designation was done correctly each child or the trustee if the beneficiary is a trust for the child can take out \$\$ over the child’s life expectancy





# WHAT IS AN INHERITED IRA?

- An IRA “inherited” by a beneficiary or
- The beneficiary of a 401(k), profit sharing plan or possibly a money-purchase pension plan who transfers the account balance to an inherited IRA

# WHAT DOES THE SECURE ACT DO?

- **Most non-spousal bens must take \$\$ out of the IRA within 10 years rather than over their life expectancies**
- Bens can take money out of IRA any way they want including waiting until the end of the 10<sup>th</sup> year
- The value of the IRA for the ben is reduced, particularly for bens who would have had many years under the IRS life expectancy table



# WHY CAN THE TAX CONSEQUENCES BE SO SIGNIFICANT?

## ■ **Loss of tax free compounding –**

If a ben takes out the money from a \$1m IRA in 10 installments, and the IRA is earning 6% interest, then:

**the amount a 50 year old can receive drops from \$3,380,000 (over life expectancy) to \$1,400,000 (over 10 years)**

**the amount a 35 year old can receive drops from \$6,045,000 to \$1,400,000**



# WHY CAN THE TAX CONSEQUENCES BE SO SIGNIFICANT?

- If a ben takes out the money from the \$1m IRA in the tenth year, and it is earning 6% interest, then:

**the amount the 50 year old can receive drops from \$3,380,000 to \$1,790,000 (pre-tax) and**

**the amount the 35 year old can receive drops from \$6,045,000 to \$1,790,000 (pre-tax)**



# WHY CAN THE TAX CONSEQUENCES BE SO SIGNIFICANT?

- Forcing distributions into taxable income over the 10 year period so that the annual payments are so much larger could put a beneficiary into a higher tax bracket at both federal and state levels
- One writer has suggested that this provision should be called the “Hidden Efforts Imposing Stealth Taxes (HEIST) Act!”

# OTHER ADVERSE CONSEQUENCES TO THE LOSS OF THE STRETCH IRA

- Before the SECURE Act many parents saved in a retirement plan knowing that any money left in the IRA after their passing could be a safety net for their bens (in most cases children)
- Forcing the ben to take \$\$ out of the IRA within 10 years will mean in many cases that the ben will spend the money rather than save it

# WHAT BENEFICIARIES ARE EXEMPT FROM THE SECURE ACT?

- **Most important exemption – surviving spouses**
- A beneficiary who is **chronically ill or disabled**
- A beneficiary who is no more than 10 years younger than the IRA owner
- **Minor children** of the IRA owner

## HOW WILL IT WORK FOR MINOR CHILDREN?

- While the child is a minor, distributions coming from the IRA can be based on prior law (i.e., based on their life expectancies)
- Upon reaching the age of majority as determined under state law (18?, 21?) – something else IRS regs? a child must take out all money from the IRA within a 10 year period – subject to the new rule



# USE OF A TRUST TO BE THE BENEFICIARY OF THE IRA

- Generally if parents are concerned that a child (or gc) will take \$\$ out of an IRA faster than is fiscally prudent or a child is still a minor, they often name a specially drafted trust as the beneficiary of the IRA so that the trustee decides how much to take out of the IRA not the child –most of these trusts will probably have to be modified
- Because of IRS regulations, these trusts were traditionally drafted to be “conduit” trusts meaning that all money coming in from the IRA to the child’s trust had to be distributed out to the child (or used for the child’s benefit or given to the child’s guardian) – the distribution from the IRA could not be “accumulated” in the trust

# USE OF A TRUST TO BE THE BENEFICIARY OF THE IRA

- The SECURE Act is likely to cause these trusts to be modified – they'll need to be changed to accumulation trusts unless IRS guidance allows trusts to stay as conduit trusts while the child is a minor and then changed to an accumulation trust once the child attains the age of majority
- Beyond the scope of this webinar but trusts will probably be designed so it is up to the trustee to determine if the trust will have Designated Beneficiaries or not in order to extend the 10 year period to the owner's remaining "ghost" life expectancy, if greater

# USE OF A TRUST TO BE THE BENEFICIARY OF THE IRA

- It is not clear whether the legislation was intended to change the existing rules – this provision is effective now and immediate guidance is needed from IRS
- Example of the problem with most existing trusts – imagine parents leave a \$1m IRA in trust for only child who is 10 years old – if the trust is a conduit trust very small distributions will be required during the years the child is under the age of majority, then the amount of the IRA (now worth likely more than \$1m) will have to be distributed out to the child within 10 years – consider the significant income tax issues for that child – let alone what the child might spend the \$\$\$ on – Ferrari anyone?

# USE OF A TRUST TO BE THE BENEFICIARY OF THE IRA

- Financial experts are going to have to figure out how to handle these trusts – if the IRA money stays in the trust so it doesn't get spent foolishly then it will be taxed at the highest levels – 37% when trusts have over \$12,750 of income

# HOW TO MINIMIZE IMPACT OF THE SECURE ACT, IF PASSED

- If owner is not close to retirement, he/she can stop making payments to the retirement plan and take funds out as comp and invest in more tax advantaged assets outside the business
- If owner is close to retirement – then he/she should consider taking distributions earlier than required

# HOW TO MINIMIZE IMPACT OF THE SECURE ACT, IF PASSED

- **Consider converting the traditional IRA to a Roth IRA** – can do this over a number of years –no income taxes will be due on the distributions from the Roth– also works well if beneficiary is a trust
- If spouse is the sole beneficiary of the Roth IRA and “assumes” the Roth IRA, spouse does not have to take any RMDs which will maximize tax free compounding in the IRA

# HOW TO MINIMIZE IMPACT OF THE SECURE ACT, IF PASSED

- **Consider investing in life insurance** – either by taking out distributions after 59 ½ and investing in insurance that is owned by a trust or by stopping plan contributions and taking it out of the company as compensation and investing in life insurance owned by a trust

# HOW TO MINIMIZE IMPACT OF THE SECURE ACT, IF PASSED

- **For those charitably inclined consider having the beneficiary of the IRA be a charitable remainder trust (CRT)** – the CRT would pay annual income to the beneficiary(ies) for a term of years or for life. Any remaining funds would go to the charity. Beneficiary cannot get larger payments – no lump sums or flexibility – works best for those charitably inclined
- Appears it is possible to terminate the CRT early
- New Pooled Income Fund – this has to be set up while IRA owner is alive





# CHANGES TO ESTATE PLANNING DOCUMENTS

- If the SECURE Act is passed as is, then people with larger retirement plan account balances will need to have their estate planning documents reviewed and probably revised
- Beneficiary designations should be reviewed and possibly revised
- For those with larger retirement plan account balances, their financial planner/accountant/tax lawyer should consider ways to minimize the impact of this new stealth tax



QUESTIONS?

Thank you for joining us!



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