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RETIREMENT LEGISLATION & REGULATION

House Ways and Means Committee Votes to Move Retirement Legislation Forward

Prepared for Franklin Templeton by Davis & Harman LLP

April 2019

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On April 2, 2019, the House Ways and Means Committee favorably voted out the "Setting Every Community Up for Retirement Enhancement Act of 2019" (the "SECURE Act"). The SECURE Act combines elements of the Retirement Enhancement and Savings Act ("RESA"), which passed the Senate Finance Committee unanimously in 2016, and the Family Savings Act ("FSA"), which passed the House of Representatives in late 2018, and a few additional provisions. The SECURE Act was passed unanimously by the Ways and Means Committee by voice vote.

Next Steps. With bipartisan support in the Ways and Means Committee, and co-sponsorship by Ways and Means Committee Chairman Richard Neal (D-MA) and Ranking Member Kevin Brady (R-TX), the SECURE Act has good prospects for House passage this year, although the precise path forward has not been determined. It is possible the bill could be brought to the House floor for a vote, or could be held and added to "must pass" legislation.

To become law, of course, identical legislation must be passed by the Senate. On April 1, Senate Finance Committee Chairman Chuck Grassley (R-IA) and Ranking Member Ron Wyden (D-OR) reintroduced RESA. The reintroduced Senate bill is nearly identical to prior versions of RESA, although there are some changes with respect to the "stretch" provision, described below, and thus does not contain a number of provisions of the SECURE Act. The Senate bill also contains provisions unrelated to private retirement plans that are not contained in the SECURE Act, including relating to retirement benefits for tax court judges. Even though these differences would eventually need to be worked out, reintroduction of RESA on the Senate side by the Chairman and Ranking member of the Finance Committee is an important step towards passage.

Summary of Provisions of SECURE Act. A summary of the key provisions of the SECURE Act is below. The provision is otherwise contained in RESA as reintroduced on April 1, except where noted.

- **Open MEPs and repeal of the one bad apple rule**. This provision would (1) allow completely unrelated employers to participate in a multiple employer defined contribution plan ("open MEP"), and (2) generally eliminate the rule under which the violation of the qualification rules by one employer in a defined contribution MEP disqualifies the entire MEP (thus eliminating the "one bad apple rule"). ***This provision is contained in RESA, although there are some differences. For example, the SECURE Act would be effective in 2021; the RESA version would not be available until 2023.***

- **Increase in age 70 ½ for required minimum distributions to 72**. Under the bill, the age 70 ½ trigger for taking required minimum distributions would be raised to age 72, effective for distributions after 2019 with respect to individuals who attain age 70 ½ after 2019. Under the effective date, if an individual attains age 70 ½ in 2019, such individual will need to take a required minimum distribution for 2019 and 2020, even though he or she may not attain age 72 until 2021. ***This provision is not contained in RESA.***

- **Stretch provision**. This provision is often referred to as the Stretch IRA provision, even though it applies to defined contribution plans too. The required minimum distribution ("RMD") rules very generally require that IRA and plan distributions start shortly after the IRA owner or participant attains age 70 ½. When the IRA owner or participant dies, the beneficiary is permitted to draw down the IRA or plan benefits over the beneficiary's life expectancy. Under the SECURE Act provision, IRA and plan designated beneficiaries would be required to draw down all assets in the IRA or plan within 10 years (five years for non-designated beneficiaries such as a trust) of the death of the IRA owner or plan participant, subject to a few exceptions. First, this new rule does not apply to defined benefit plans. Second, the new rule does not apply if the

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designated beneficiary is an "eligible designated beneficiary," i.e., a beneficiary who is (1) the surviving spouse of the IRA owner or plan participant, (2) a child who has not attained the age of majority, (3) disabled, (4) chronically ill, or (5) not more than 10 years younger than the IRA owner or plan participant. In the case of a child who has not attained the age of majority, the ten-year rule would apply as of the date the child attains the age of majority. The new rule would generally apply with respect to deaths after 2019. There are delayed effective dates for collectively bargained plans and for governmental plans and for making plan amendments. The new rules do not apply to a qualified annuity which is a binding contract as of the date of enactment of the bill. ***This provision is contained in RESA, but modified from prior versions. In the latest Senate version, the five year rule applies for any beneficiary other than an "eligible designated beneficiary," but only to the extent the interest of the beneficiary, determined at death, exceeds $400,000 (indexed).***

- **Post-70 ½ contributions to a traditional IRA**. Under current law, an individual who has attained age 70 ½ by the end of the year cannot make a non-rollover contribution to a traditional IRA. This age limitation would be repealed.

- **Long-term part-time workers**. Under current law, employers generally may exclude certain part-time employees (i.e., employees who have not satisfied a requirement that they have 1,000 hours of service in a year) when providing a plan to their employees. Except in the case of collectively bargained plans, the bill would require employers maintaining a 401(k) plan to have a dual eligibility requirement under which an employee must complete either a one year of service requirement (with the 1,000-hour rule) or three consecutive years of service where the employee completes at least 500 hours of service. In the case of employees who are eligible solely by reason of the latter new rule, the employer (1) is not required to provide any otherwise applicable matching or nonelective contributions, and (2) may elect to exclude such employees from testing under the nondiscrimination and coverage rules (including the 401(k) safe harbor rules), and from the application of the top-heavy rules. ***This provision is not contained in RESA*.**

- **Penalty-free distributions upon the birth or adoption of a child**. Upon birth or adoption of a child, a participant may withdraw up to $5,000 (reduced from $7,500 in FSA) penalty-free from a defined contribution plan (if permitted by the plan) or an IRA. Such distributions may also be repaid, in which case the repayment would be treated like a rollover. ***This provision is not contained in RESA*.**

- **Increasing the 10% limit on automatic escalation to 15%**. Under the current laws' nondiscrimination safe harbor for automatic enrollment and automatic escalation, a plan may not automatically enroll or escalate employees so that they make contributions that exceed 10% of pay. The SECURE Act would maintain the 10% cap for the first year in which the employee is automatically enrolled but would increase the limit to 15% after that first year. ***RESA's version simply removes the cap completely***.

- **Expanded uses for 529 accounts**. The bill includes provisions that would permit 529 accounts to make tax-free distributions to pay for elementary and secondary school expenses and certain homeschooling expenses, up to the annual limit of $10,000. It would also permit 529 accounts to make tax-free distributions to repay student loans, up to a lifetime limit of $10,000. Finally, the bill would permit tax-free distributions to pay for certain apprenticeship programs. ***These provisions were drawn from the House-passed Family Savings Act, not RESA.***

- **Lifetime income disclosure**. The SECURE Act would require a benefit statement provided to a defined contribution plan participant to annually include a lifetime income disclosure. The lifetime income disclosure is required to set forth the lifetime income stream equivalent of the participant's total account balance under the plan in the form of both a qualified joint and survivor annuity and a single life annuity. If the disclosure is made using DOL-prescribed assumptions and explanations, no one would have liability attributable to the lifetime income disclosure.

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- **Fiduciary safe harbor for selecting an annuity provider**. Under this proposal, for purposes of fulfilling their fiduciary duty to consider an annuity provider's financial capability to fulfill its obligations, defined contribution plan fiduciaries may rely on representations from insurers regarding their status under state insurance laws.

- **Adoption of a plan**. Currently, a plan must be adopted by the end of the employer's taxable year in order to be effective for that year. The SECURE Act would allow an employer to adopt a plan for a taxable year as long as it is adopted by the due date for the tax return for that year.

- **Electing safe harbor 401(k) status**. The bill would streamline compliance for 401(k) plans that meet the nondiscrimination safe harbors, by eliminating the notice requirement with respect to plans that satisfy the safe harbor through the use of nonelective contributions, and allowing a plan to elect safe harbor status after the beginning of the plan year, if certain conditions are satisfied.

- **Increased credits for small business retirement plans**. Under current law, employers with up to 100 employees are entitled to an annual tax credit for three years equal to 50% of the costs of starting up and administering a retirement plan, up to a cap on the annual credit of $500. The proposal would increase the $500 cap to the lesser of (1) $5,000 or (2) $250 multiplied by the number of nonhighly compensated employees eligible to participate in the plan. Small employers that adopt automatic enrollment provisions are eligible for an additional $500 credit for three years, regardless of whether the automatic enrollment provisions are adopted when the plan is first effective, or the provisions are adopted later.

- **IRA contributions of stipend payments**. Under the proposal, an amount that is taxable and paid to an individual to help the individual with respect to graduate study or research is treated as compensation on which IRA contributions can be based.

- **Credit card loans from plans**. This proposal would prohibit credit card loans from plans. ***RESA contains the provision, but also includes a grandfather rule for plans that provided credit card loans as of September 21, 2016.***

- **Portability of lifetime income products**. This proposal would facilitate portability of lifetime income products held in retirement plans. Plan participants would be allowed to take a distribution of a "lifetime income investment" without regard to the restrictions on plan withdrawals (i.e., prior to a "distributable event," i.e., death, disability, age 59 ½, termination of employment, *etc.*). The distribution would be allowed only if (1) the lifetime income investment is no longer authorized to be held under the plan, and (2) the distribution is made *via* (a) a direct rollover to an IRA or other retirement plan, or (b) a distribution of an annuity contract.

- **Other Revenue Raisers**. In addition to the "stretch" provision described above, the SECURE Act contains additional provisions to offset the cost of the bill. For example it would increase the penalty for failure to file Form 5500, for failure to file a registration statement regarding deferred vested participants, and for failure to provide a required withholding notice.

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