WR Marketplace

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Topic: The IRS Provides Much Needed Clarity to the SECURE Act and Miners Act Retirement Plan and IRA Rules

Market trend: On September 2, 2020, the Internal Revenue Service ("IRS") issued Notice 2020-68 (the "Notice"), to provide initial guidance under the Setting Every Community Up for Retirement Enhancement Act of 2019 ("SECURE Act") and the Bipartisan American Miners Act of 2019 ("Miners Act"). The Notice addresses certain provisions in those acts related to 401(k) and other qualified retirement plans, 403(b) plans, governmental 457(b) plans, and Individual Retirement Arrangements ("IRAs").

Synopsis: The Notice provides the first round of guidance with respect to key provisions of the SECURE Act and Miners Act, including (i) implementing the small employer automatic enrollment credit; (ii) repealing the maximum age for making traditional IRA contributions; (iii) providing participation in 401(k) plans by long-term, part-time employees; (iv) authorizing penalty-free distributions of qualified birth or adoption distributions; (v) requiring excluded "difficulty of care" payments to be taken into account as compensation for purposes of determining certain retirement contribution limitations; and (vi) reducing the minimum age for in-service distributions from governmental 457(b) plans and pension plans. The Notice clarifies which of these changes are voluntary versus required, and also clarifies when plan amendments are required. The IRS intends to issue further guidance on these rules in the

coming months, likely in the form of regulations. In the meantime, employers wishing to provide comments on the Notice must submit their comments to the IRS by November 2, 2020.

Takeways: Plan sponsors of qualified plans and financial institutions sponsoring IRAs should review the Notice to determine which mandatory provisions they are required to adopt, and which voluntary provisions they would like to adopt. Plan sponsors and applicable financial institutions will also need to ensure they make any necessary operational changes to their plans and/or policies and update plan documents and related materials by the required deadlines.

The Notice,[1] issued by the IRS, provides sponsors of qualified plans, 403(b) plans, and 457(b) governmental plans, as well as financial institutions sponsoring IRAs, with much needed clarity with respect to certain provisions in the SECURE Act[2] and the Miners Act. The Notice provides guidance on the following provisions of the SECURE Act:

- Small employer automatic enrollment credit;
- Repeal of maximum age for traditional IRA contributions;
- Participation of long-term, part-time employees in 401(k) plans;
- Qualified birth or adoption distributions; and
- Permitting excluded "difficulty of care" payments to be taken into account as compensation for purposes of determining certain retirement contribution limitations.

The Notice also addresses requirements under the Miners Act regarding the reduction in minimum age for in-service distributions from governmental 457(b) plans and defined benefit pension plans. Additionally, the Notice clarifies certain plan amendment deadlines.

Each of these provisions are explained in more detail below.

Small Employer Automatic Enrollment Credit

The Small Employer Automatic Enrollment Credit[3] provides a $500 per year general business tax credit to employers who have no more than 100 employees receiving more than $5,000 in compensation in the preceding year, referred to as "small employers." A small employer that establishes an eligible automatic contribution arrangement ("EACA")[4] under a qualified plan may

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[1] The full text of the Notice is available at https://www.irs.gov/pub/irs-drop/n-20-68.pdf.

[2] For more information on the SECURE Act, please see our prior Marketplace article, The SECURE Act Is Here, Now What Do We Do?

[3] SECURE Act Div. O, § 105.

[4] Under an EACA, employees are deemed to have elected to defer compensation at a specified level, unless the employee affirmatively elects not to participate or to defer at a different level. Certain notice requirements apply to EACAs.

take this tax credit for up to three years. This new credit became available for taxable years beginning after December 31, 2019.

The Notice clarifies that an eligible employer may receive a credit for taxable years only during a single 3-year period that begins when the employer first includes an EACA in any qualified plan. If the eligible employer decides to utilize the tax credit in year 2 or 3 of the credit period, the Notice provides that the eligible employer must continue to maintain the same EACA in the same plan in the second and third year (except in cases of a plan spin-off). If an employer has more than one plan with an EACA, the employer receives the tax credit only once.

The Notice also provides that in the context of a multiple employer plan ("MEP") the credit is available to each eligible employer that participates in the MEP.[5]

These tax credit provisions are voluntary, since they apply only to small employers who adopt plans with an EACA feature and that otherwise actually seek the tax credit.

Repeal of Maximum Age for Traditional IRA Contributions

Before the SECURE Act, the Internal Revenue Code of 1986, as amended (the "Code") prohibited an individual from making contributions to the his or her traditional IRA for the taxable year if he or she reached age of 70 ½ before the end of the year.[6] The SECURE Act, however, eliminates this restriction beginning for taxable years after December 31, 2019.

The Notice clarifies that financial institutions that serve as trustees, issuers, or custodians for IRAs are not required to accept post-age 70½ contributions but may choose to accept such contributions beginning January 1, 2020. If a financial institution decides to accept post-age 70½ contributions, then it will be required to amend its IRA contracts to account for these contributions. Such amendment must be adopted no later than December 31, 2022. In addition, the Notice requires financial institutions that amend their IRA contracts to distribute a copy of the amendment to the IRA contract and a new disclosure statement to each benefited individual no later than 30 days after the date on which the amendment is adopted or, if later, the date it becomes effective.

The Notice also addresses the impact of post-age 70 ½ IRA contributions on the exclusion from income of certain post-age 70 ½ charitable contributions made from IRAs, as required by the SECURE Act. Section 408(d)(8) of the Code permits individuals older than age 70 ½ to exclude from income certain charitable contributions made from their traditional and ROTH IRAs, up to $100,000 per year. For taxable years after December 31, 2019, the SECURE Act reduces the amount that can be excluded from income by the amount of any post-age 70 ½ IRA contributions. The Notice includes the following example to illustrate how the IRS intends for this rule to work:

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[5] For more information on the SECURE Act guidance related to MEPs, please see our prior Marketplace article, SECURE Act Expands Opportunities for "Open MEP" 401(k) Plans

[6] SECURE Act Div. O, § 107.

Suppose an individual who turned age 70½ before 2020 deducts $5,000 for contributions for each of 2020 and 2021 but makes no contribution for 2022. The individual makes no qualified charitable distributions for 2020 and makes qualified charitable distributions of $6,000 for 2021 and $6,500 for 2022.

The excludable amount of qualified charitable distributions for 2021 is the $6,000 of qualified charitable distributions reduced by the $10,000 aggregate amount of post-age 70½ contributions for 2021 and earlier taxable years ($5,000 in 2020 and $5,000 in 2021). As such, no amount of qualified charitable distributions for 2021 is excludable for the individual ($6,000 - $10,000 = ($4,000)).

The excludable amount of the qualified charitable distributions for 2022 is the $6,500 of qualified charitable distributions for 2022 is reduced by the portion of the $10,000 aggregate amount of post-age 70½ contributions deducted that did not reduce the excludable portion of the qualified charitable distributions for earlier taxable years. Thus, $6,000 of the aggregate amount of post-age 70½ contributions deducted does not apply for 2022 because that amount has reduced the excludable amount of qualified charitable distributions for 2021. The remaining $4,000 of the aggregate amount of post-age 70½ contributions deducted reduces the excludable amount of any qualified charitable distributions for subsequent taxable years. Accordingly, the excludable amount of the qualified charitable distributions for 2022 is $2,500 ($6,500 - $4,000 = $2,500).

Since the $4,000 amount reduced the excludable amount of qualified charitable distributions for 2022, that $4,000 amount does not apply again in later years, and no amount of post-age 70½ contributions remains to reduce the excludable amount of qualified charitable distributions for subsequent taxable years.

The Notice prohibits individuals from offsetting the amount of required minimum distributions from the individual's IRA by the amount of post-age 70½ contributions for the same taxable year. The IRS treats contributions and distributions as separate transactions that are each independently reported by the financial institution to the IRS.

The Notice states that the IRS anticipates issuing revised model IRAs and prototype language to address these changes under the SECURE Act.

Participation of Long-Term, Part-Time Employees in Section 401(k) Plans

Generally, a qualified retirement plan may exclude employees from participation who do not attain age 21 or complete a 12-month period with at least 1,000 hours of service. The SECURE Act, however, adds a new, mandatory eligibility rule for certain long-term, part-time employees. Under the new eligibility rule, an employee who works for at least 500 hours per year with an employer for at least three consecutive 12-month periods (and who attains age 21 by the end of the three consecutive 12-month periods) must be made eligible to participate in their employer's qualified 401(k) plan for purposes of

making elective deferrals.[7] The new eligibility rule applies only to eligibility to make 401(k) pre-tax deferrals, and does not require that these employees be made eligible to receive employer contributions under the plan.

If a long-term, part-time employee becomes eligible to participate under the new rule, and if the employer allows the employee to receive employer contributions that are subject to a vesting schedule, the SECURE Act also adds a special vesting service rule. Under this rule, the eligible long-term, part-time employees must be credited with a year of vesting service for each 12-month period during which the employee completes at least 500 hours of service.

These provisions become effective for plan years starting after January 1, 2021. The Notice clarifies and confirms that the three consecutive 12-month periods with at least 500 hours of service for determining eligibility of a long-term, part-time employee excludes any 12-month periods beginning before January 1, 2021. As a result, the first time an employee could become eligible to participate under the new requirement is at the end of 2023 (i.e., assuming at least 500 hours of service in each of 2021, 2022, and 2023).

The Notice, however, provides that the new vesting service rule applies to any 12-month period with at least 500 hours of service, including those periods that began before January 1, 2021. As a result, if an employee becomes eligible to participate in a plan as a result of the long-term, part-time employee eligibility requirement and is eligible to receive employer contributions that are subject to a vesting schedule, the employer will need to be able to determine the additional years of vesting service for 12-month periods before January 2021.

This new vesting service rule may add administrative burdens to allowing long-term, part-time employees to receive employer contributions. The IRS recognizes the potential administrative burdens and is requesting comments. Any employer wishing to provide comments to this provision must do so by November 2, 2020.

Qualified Birth or Adoption Distributions

Generally, the Code imposes a 10% additional tax on an early distribution from a qualified retirement plan (including a traditional or ROTH IRA), unless the distribution qualifies for an exception under the Code.

The SECURE Act amends this provision of the Code to add a new exception to the 10% early withdrawal tax for “qualified birth or adoption distributions” from an eligible retirement plan made after December 31, 2019.[8] Although, a qualified birth or adoption distribution is not subject to the additional tax penalty, the Notice clarifies that the distribution is includible in gross income.

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[7] SECURE Act Div. O, § 112.

[8] SECURE Act Div. O, § 113.

The SECURE Act permits an individual to take a qualified birth or adoption distribution from an eligible retirement plan of up to $5,000 without the application of the 10% additional tax. A "qualified birth or adoption distribution" is a distribution of up to $5,000 from an eligible retirement plan to an individual that is made during the 1-year period beginning on the date on which the child (or children) of the individual is born or the legal adoption by the individual of an eligible adoptee (or eligible adoptees) is finalized. For purposes of this provision, an "eligible adoptee" means any individual who has not attained age 18 or is physically or mentally incapable of self-support. However, the Notice specifically provides that an eligible adoptee does not include an individual who is the child of the taxpayer's spouse. Each parent may receive a qualified birth or adoption distribution of up to $5,000 from their respective retirement plans for the same child or eligible adoptee (i.e., a total of $10,000). Also, the Notice clarifies that a distribution may be requested for each birth or adopted child that otherwise qualifies. For example, the Notice states that a birth of twins could qualify for two separate $5,000 distributions (one for each child).

The Notice clarifies that the SECURE Act does not require that a plan permit qualified birth or adoption distributions. If a plan chooses to permit such distributions, the plan administrator may reasonably rely on representations from the individual that they are eligible for the distribution (unless the plan sponsor or administrator has actual knowledge to the contrary).

The Notice also provides guidance surrounding the recontribution rules with regard to qualified birth or adoption distributions. If a plan permits qualified birth or adoption distributions, it generally must allow an individual who took a qualified birth or adoption distribution from that plan to recontribute any portion of the distribution at a later date.[9]

If an individual's plan does not allow qualified birth or adoption distributions and such individual receives an otherwise permissible in-service distribution that satisfies the requirements of a qualified birth or adoption distribution, the individual may treat the distribution as a qualified birth or adoption distribution on his or her tax return. The distribution, while includible in gross income, is not subject to the 10% additional tax under § 72(t)(1). If the individual decides to recontribute the amount to an eligible retirement plan, the individual may recontribute the amount to an IRA.

In order for an in-service distribution to be treated as a qualified birth or adoption distribution with respect to any child or eligible adoptee, the individual must include the name, age, and the Taxpayer Identification Number of the child or eligible adoptee on the individual's tax return for the taxable year in which the distribution is made.

While plan sponsors are not required to permit in-service distributions for qualified birth or adoption distributions, if the plan sponsors decides to implement such a distribution, the plan will need to be amended to add the distribution and an updated summary plan description (or summary of material modifications) will need to be furnished.

[9] The plan would not have to accept a recontribution if the individual was otherwise not eligible to make a rollover contribution to the plan at that time.

Treating Excluded Difficulty of Care Payments as Compensation for Determining Retirement Contribution Limitations

The SECURE Act amends the Code to provide that "difficulty of care" payments that are excluded from taxable compensation under Code Section 131 are now included in compensation for purposes of calculating the contribution limits to defined contribution plans and IRAs. [10] A "difficulty of care" payment is a type of qualified foster care payment that a state determines is needed to provide additional care to a qualified foster individual with a disability.

The Notice makes it clear that if an employer provides difficulty of care payments to its employees, then those payments are required to be included in a participant's compensation for purposes of calculating the annual contributions limit.

If, however, an employer does not make difficulty of care payments to its employees, then the employer's plan does not need to be amended to include difficulty of care payments in the plan's definition of compensation. However, if the employer decides to begin making difficulty of care payments to its employees, the plan must then be amended to include difficulty of care payments in the compensation definition.

Minimum Age for In-Service Distributions from Pension and 457(b) Plans

The Miners Act lowered the minimum age for permissible in-service distributions from 62 to 59½ for a defined benefit pension plan, and from 70½ to 59½ for a 457(b) governmental plan, effective for plan years after December 31, 2019.[11] The Notice clarifies that it is optional for a pension plan or a § 457(b) governmental plan to provide for in-service distributions. Additionally, the Notice provides that these changes do not impact the plan's definition of normal retirement age.[12]

Deadline for Plan Amendments

The deadline for amendments reflecting SECURE Act revisions and Section 104 of the Miners Act is generally the last day of the plan year beginning on or after January 1, 2022 (or on or after January 1, 2024, for governmental plans and collectively bargained plans). This plan amendment deadline applies both to mandatory and discretionary changes under the new rules.

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[10] SECURE Act Div. O, § 116.

[11] Miners Act § 104.

[12] IRS regulations under Code Section 401(a) require that defined benefit pension plans include a normal retirement age that is not earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed. Age 62 is a safe harbor earliest normal retirement age under this requirement.

Comment Period

The Treasury Department and the IRS are requesting comments on the topics covered in the Notice. In particular, the Treasury Department and the IRS request comments on how to reduce the potential administrative burdens related to counting pre-2021 vesting years of service for long-term, part-time employees. Any comments must be submitted on or before November 2, 2020.