September 16, 2020

IRS Provides Additional SECURE Act Guidance

At the end of 2019, the President signed the most comprehensive retirement reform package in over a decade: the Setting Every Community Up for Retirement Enhancement (SECURE) Act. The SECURE Act is one of multiple bills that were included in the Further Consolidated Appropriations Act, 2020 (FCAA).

The SECURE Act's primary goals include expanding retirement savings, simplifying existing rules, and preserving retirement income. As with any major legislation, the SECURE Act created numerous outstanding questions. And while the IRS has previously provided some answers, no SECURE Act guidance has been as detailed as the recently released IRS Notice 2020-68. In addition to providing guidance on the SECURE Act, this Notice provides guidance on the Bipartisan American Miners Act, which is also part of FCAA.

SECURE Act Guidance

Qualified charitable distributions and the repeal of the Traditional IRA contribution age limit

Effective for 2020 and later taxable years, taxpayers with eligible compensation can make Traditional IRA contributions at any age, not just for years before reaching age 70½. Notice 2020-68 states that financial organizations that accept such contributions must amend their Traditional IRA plan agreements and disclosure statements and provide the amended documents to IRA owners.

Although most financial organizations are likely to adopt the relaxed eligibility requirements, Notice 2020-68 states that they are not *required* to accept such contributions. Keeping the old contribution limitation—or delaying implementing the new rule—may benefit organizations who face possible programming concerns.

The Notice confirms that, because IRA contributions and required minimum distribution (RMDs) are reported as two separate transactions, IRA owners may not offset their RMD amount for a taxable year by the amount of contributions made for the same year. So while Traditional IRA owners may contribute past age 70½ (if they are otherwise eligible), they may also have to take an RMD for the same year.

In addition to allowing individuals to make contributions after age 70½, the SECURE Act made changes to qualified charitable distributions (QCDs). Beginning at age 70½, IRA owners and beneficiaries may donate—while satisfying their RMDs—up to $100,000 of IRA assets tax-free to a qualified charity.

The SECURE Act requires that IRA owners age 70½ and older who make deductible Traditional IRA contributions reduce the amount that they can exclude from income when taking a QCD. Notice 2020-68 confirms the formula that IRA owners should use to determine this amount.

Example: In 2020, Mike attains age 70½ and makes a $7,000 deductible contribution to his Traditional IRA. Mike also takes a $9,000 distribution payable directly to his church, which is a qualified charity. How much of the $9,000 QCD can Mike exclude from income?

Excludable QCD amount = A – (B – C)
A = the QCD amount for a year before any reduction
B = the aggregate deductible contributions made for all tax years beginning with Mike's 70½ year
C = prior year income exclusion reductions made as a result of the SECURE Act

Excludable QCD amount = $2,000, which is $9,000 – ($7,000 – $0)

NOTE: *In future years, deductible contributions made after age 70½ will continue to lessen the amount by which QCDs will be excluded from income. Contributions that reduced the excludable QCD amount in previous years are ignored; contributions that have not reduced prior-year excludable QCD amounts are aggregated with current-year deductible contributions to determine what amount of the current QCD is included in income.*

Participation of long-term, part-time employees in 401(k) plans
Effective for 2021 and later plan years, employees who have three consecutive 12-month periods with at least 500 hours of service (and who satisfy the plan's minimum age requirement) generally must be allowed to make elective deferrals in an employer's 401(k) plan. The current, more restrictive, eligibility rules could continue to be applied to other contribution sources (such as matching contributions) and to ADP/ACP safe harbor plans. Employers may also exclude such part-time employees from coverage, nondiscrimination, and top-heavy test rules. The SECURE Act states that no 12-month period that begins before January 1, 2021, is considered when determining the three years of service for eligibility.

Notice 2020-68 confirms that an employer can apply the new eligibility rule to employer contributions that are subject to vesting requirements. But then for vesting purposes, the employer must generally consider each 12-month period for which the employee has at least 500 hours of service starting from the employee's date of hire—including periods of service incurred before January 1, 2021. An employer may, however, continue to exclude periods of service described in Internal Revenue Code Section (IRC Sec.) 411(a)(4) (such as periods of service incurred before age 18 or before the plan was established).

It may be difficult for some employers to determine the correct periods of service for an employee who was previously excluded from the employer's plan. As a result, the IRS is seeking comments on how to reduce possible administrative concerns related to counting years of vesting service beginning before January 1, 2021.

Small-employer automatic-enrollment tax credit
The SECURE Act created a new tax credit for small employers that include an eligible automatic contribution arrangement (EACA) feature in their new or existing qualified employer plan. A "qualified employer plan" includes a 401(a) plan, a 403(a) plan, a simplified employee pension (SEP) plan, and a savings incentive match plan for employees of small employers (SIMPLE) plan. To be eligible for the credit, employers must have had 100 or fewer employees who earned at least $5,000 in compensation during the previous calendar year. The maximum annual tax credit is $500 for each of the first three years that the employer includes an EACA in a qualified employer plan. This provision is effective for 2020 and later taxable years.

Notice 2020-68 clarifies that employers may receive a credit for each year during a single three-year period, starting in the first year that an employer adds an EACA. In addition, employers that maintain more than one qualified employer plan must offer an EACA in the same qualified employer plan for each year of the three-year period. For example, an employer that maintains two different 401(k) plans cannot receive a tax credit in 2021 if it adds an EACA to Plan A in 2020, amends to remove the EACA from Plan A in 2021, and then amends to add the EACA to Plan B in 2021.

Notice 2020-68 also clarifies that each eligible employer that participates in a multiple employer plan (MEP) may receive the tax credit. The three-year period begins with the first taxable year that an eligible employer includes an EACA under a MEP. An employer will continue to be eligible for the credit even if it spins off and establishes its own single-employer plan.

Qualified birth or adoption distributions (QBADs)
As of January 1, 2020, distributions taken within 12 months of the birth of a child or adoption of an "eligible adoptee" are exempt from the 10 percent early distribution penalty tax. An eligible adoptee is a child under the age of 18 or an

individual who is physically or mentally incapable of self-support. An eligible adoptee does not include a child of the individual's spouse. Each parent may distribute up to $5,000 in aggregate, per birth or adoption event, from an IRA, a 401(a) defined contribution plan, a 403(a) or 403(b) annuity plan or contract, or a governmental 457(b) plan.

Individuals may repay these amounts to an IRA or eligible retirement plan. While there is currently no stated deadline for repaying a QBAD, the Treasury Department plans to issue regulations under IRC Sec. 72(t) that will address recontribution rules, including rules related to the timing of recontributions.

Notice 2020-68 clarifies that individuals are "physically or mentally incapable of self-support" if they meet the disability definition found in IRC Sec. 72(m)(7). According to this definition, an individual is disabled if he "is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to result in death or to be of long-continued and indefinite duration."

In addition, the Notice addresses several other matters.

- Individuals may receive a QBAD for each birth and each adoption. For example, an individual who gives birth to twins may distribute $10,000 from her IRA and treat the entire amount as a QBAD.
- A QBAD is not treated as an eligible rollover distribution for purposes of the direct rollover rules, the IRC Sec. 402(f) notice requirement, and the 20 percent mandatory withholding requirement.
- A QBAD is an optional distributable event, so employers are not required to add the feature to their plans.
- A plan administrator may rely on a reasonable representation that the individual is eligible for a QBAD, unless the administrator has actual knowledge to the contrary.
- An eligible retirement plan must accept QBAD recontributions if 1) the retirement plan permits QBADs, 2) the individual received a QBAD from that plan, and 3) the individual is otherwise eligible to make a rollover contribution to that plan at the time he wishes to recontribute the QBAD to the plan.
- A QBAD that is recontributed to an eligible retirement plan is deemed to be an eligible rollover distribution that meets the 60-day rollover rule.
- A participant who receives an in-service distribution from a plan that does not offer QBADs may still claim that distribution as a QBAD on her income tax return and recontribute the amount to an IRA.

Difficulty-of-care compensation eligible for IRA contributions

Certain foster care providers receive payments that are not includable in taxable income and therefore were not considered to be compensation. As a result, such individuals may not have been able to contribute to a retirement plan. Now such after-tax "difficulty-of-care payments" will qualify as eligible compensation for IRAs and defined contribution plans. This provision is effective for IRA contributions made after December 20, 2019, and for contributions made to defined contribution plans in 2016 and later plans years.

Notice 2020-68 confirms that difficulty-of-care payments to an employee must be made by the employer in order to be treated as eligible compensation. Employers that make difficulty-of-care payments to their employees must amend their retirement plans to include difficulty-of-care payments in their plan's definition of compensation. Notice 2020-68 also notes that the IRS will release future guidance to address whether the six percent penalty tax will apply to excess IRA contributions that are based on difficulty-of-care payments.

Bipartisan American Miners Act Guidance

Under IRC Sec. 401(a)(36), pension plans could allow in-service distributions at age 62. Effective for 2020 and later plan years, the Bipartisan American Miners Act allows in-service distributions at age 59½ to participants in governmental 457(b) plans and 401(a) pension plans.

Notice 2020-68 verifies that allowing participants to take in-service distributions starting at age 59½ does not solely affect the plan's normal retirement age. A pension plan's definition of normal retirement age must still meet the requirements of Treas. Reg. 1.401(a)-1(b)(2), which states that a plan's normal retirement age may not be earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed. A normal retirement age that is age 62 or later is deemed to satisfy the reasonably representative requirement. Notice 2020-68 also states that employers may continue to rely on the proposed regulations that were issued in 2016 for governmental pension plans. Employers are not required to offer the age 59½ in-service distribution.

Amendment Guidance

To help synchronize amendment deadlines for the SECURE Act, the Bipartisan Miners Act, and the Coronavirus Aid, Relief, and Economic Security Act, Notice 2020-68 states that employers with qualified retirement plans and 403(b) plans that are not maintained by a public school will have until the last day of the first plan year beginning on or after January 1, 2022, to amend their plans for the SECURE Act and the Bipartisan American Miners Act. This is a change from the Bipartisan Miners Act, which gave employers until the end of their 2020 plan year to amend their plan documents. Those employers with qualified governmental plans under IRC Sec. 414(d), collectively bargained (union) plans, and 403(b) plans maintained by a public school have until the last day of the first plan year beginning on or after January 1, 2024.

Governmental 457(b) plan administrators must amend their documents for the SECURE Act and the Bipartisan American Miners Act by the later of the last day of the first plan year beginning on or after January 1, 2024, or if applicable, the first day of the first plan year beginning more than 180 days after the date of notification by the IRS that the plan was administered in a manner that is inconsistent with the requirements of IRC Sec. 457(b).

Notice 2020-68 provides long awaited IRA amendment guidance. The Notice states that financial organizations must amend their IRA plan agreements and disclosure statements for the SECURE Act by December 31, 2022, or a later date as prescribed by the Treasury Secretary. The IRS expects to issue revised model IRA documents and an updated Listing of Required Modifications (LRMs). The LRMs will contain sample language that document providers may use when updating their IRA prototype documents. Employers must amend their deemed IRA documents based on the deadline applicable to the retirement plan under which the deemed IRA is established.

Next Steps

If they haven't already, employers and financial organizations should educate themselves and their staff on the new requirements and determine whether they will offer any of the optional provisions. They should also start considering the amendment process for their retirement plan and IRA documents.

The IRS is requesting comments on the topics covered in Notice 2020-68—especially on the provision relating to long-term, part-time employees. Comments must be submitted on or before November 2, 2020, and should refer to Notice 2020-68. The Treasury Department and IRS are still expected to provide further guidance—including new regulations—on the SECURE Act and Bipartisan American Miners Act.

Ascensus will continue to follow any new guidance as it is released. Visit ascensus.com for the latest developments.