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Voices SECURE Act would have an impact on 401(k)s and profit-sharing plans

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Published June 26 2019, 12:36pm EDT

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The House overwhelmingly voted in May to approve the SECURE (Setting Every Community Up for Retirement Enhancement) Act, which aims to enhance retirement security. In our previous article, SECURE Act offers possible retirement strategies for accountants to discuss with clients, we spoke about the SECURE Act and the changes being made to IRAs and 401(k)s. Since then we have been receiving questions about how this would impact 401(k) and profit-sharing plans.

There are several legislative proposals out there that would affect 401(k) and profit-sharing plans. In addition to the SECURE Act, the Senate has the Retirement Enhancement and Savings Act of 2019 (RESA), as well as the Retirement Security and Savings Act of 2019 (RSSA). Congress will eventually have to consolidate all three of these proposed bills into one. Here is how these three bills will affect 401(k) and profit-sharing plans.

Both RESA and the SECURE Act make changes to the required minimum distribution rules. The SECURE Act changes the stretch period to a maximum of 10 years. RESA allows a stretch on the first $400,000 of aggregated IRAs and the excess balance must be distributed within five years. How are they going to track beneficiaries' 401(k)s and profit-sharing plans? Congress will create a new form that will report to the IRS the current account balance of a designated beneficiary, the year of death of the participant, and the account balance as of the date of death. While some financial institutions will be handling this kind of reporting, many brokerage accounts will not. For the accountant who is filing a Form 5500 for a self-employed individual, it may be the job of the accountant to report beneficiary information.

The SECURE Act and RESA also state that beneficiaries who are disabled or ill will be able to be excluded from the 10-year distribution period under the SECURE Act, or the five-year period under RESA. However, what is considered disabled or ill? The SECURE Act and RESA state that the determination of disability or illness will be made for a disability or illness that is chronic or indefinite in nature, and one that is reasonably expected to be lengthy in nature. That means on the date of death, a disabled or ill beneficiary will need a doctor's note stating that on the date of death they were disabled or ill.

Before accountants will be able to file a tax return for a disabled or ill beneficiary, they will need the beneficiary to get a note stating they were disabled or ill. We wonder how many disabled or ill people will remember, or will be well enough, to get a doctor's note stating that on the date of death they were disabled or ill. This may result in higher taxes on disabled or ill people who didn't get a note or whose disability or illness is not considered to be lengthy in nature.

The SECURE ACT and RSSA also allow part-timers to participate in 401(k)s and profit-sharing plans. The solution to avoid all of this is a defined benefit plan. The SECURE Act and RESA do not make any changes to the part-timer laws for defined benefit plans — only to 401(k)s, profit-sharing plans and IRAs. Under a defined benefit plan, business owners can continue to exclude part-timers from the plan.

Both RESA and the SECURE Act also increase the fines for not filing a Form 5500. Under current law, the IRS can charge a late fee of $25 per day, up to $15,000. The proposals increase the fees to $100 per day, up to a maximum of $50,000. These are on top of the late fees for the Department of Labor who can charge $2,063 per day with no maximum.

There are some good things to come from the SECURE Act, RESA and RSSA. The SECURE Act and RESA both allow a 401(k) plan to be set up prior to the due date of the tax return. Under current law, a 401(k) would need to be set up before the end of the plan year. Both of these proposals allow taxpayers an extension of time to set up plans for the previous year.

These three proposed bills constitute significant changes that accountants will need to consider in order to determine whether it makes sense for a client to switch to a defined benefit plan. We do not know if the final regulations will include defined benefit plans in the RMD rule or not. For example, RSSA would allow a 60-day rollover for non-spouse beneficiaries to an IRA. Since all of these rules would not apply to defined benefit plans, would this mean there may be a way for beneficiaries to avoid the new RMD rules? Would the final rule allow a beneficiary to roll money from a defined benefit plan to an IRA and still allow for a stretch IRA? Both the Senate and House of Representatives will need to work out the details as to which version will be adopted and sent to the president for his signature. We will keep readers aware of any significant rule changes as they occur.

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