Ways and Means approves bipartisan retirement security enhancements

The House Ways and Means Committee on May 5 approved by voice vote a bipartisan bill introduced by Chairman Richard Neal, D-Mass., and ranking member Kevin Brady, R-Texas, that is aimed at making it easier for businesses to offer tax-qualified retirement savings plans to their employees and for individuals to participate in retirement plans and grow their tax-preferred savings.

The Securing a Strong Retirement Act of 2021 (H.R. 2954), which drew praise from Democrats and Republicans alike at the Ways and Means Committee mark-up, would build on bipartisan retirement security legislation that Congress enacted in 2019. The 2019 legislation, known as the Setting Every Community Up for Retirement Enhancement (SECURE) Act, was signed into law as part of the Further Consolidated Appropriations Act, 2020 (P.L. 116-94). (For prior coverage, see *Tax News & Views*, Vol. 20, No. 42, Dec. 19, 2019.)
URL: https://waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/SECURE%20-%20as%20Introduced.pdf
URL: http://newsletters.usdbriefs.com/2019/Tax/TNV/191219_1.html

The retirement plan enhancements and savings incentives in the Ways and Means-approved bill would reduce federal receipts by nearly $27.25 billion between 2021 and 2031, according to an estimate by the nonpartisan Joint Committee on Taxation (JCT) staff. But that amount would be more than offset by nearly $27.4 billion in revenue-raising provisions over the same period – including some that would make certain retirement accounts and retirement account contributions subject to after-tax "Roth" treatment. Overall, the JCT estimates the legislation would increase federal receipts by $158 million (net) over the 10-year window.
URL: https://www.jct.gov/publications/2021/jcx-22-21/

A description of the provisions in legislation is available from the JCT staff.
URL: https://www.jct.gov/publications/2021/jcx-21-21/

It is not immediately clear when House Democratic leaders will bring the measure to the floor for a vote by the entire chamber.

Saving more, saving longer

Several provisions in the Ways and Means-approved legislation would allow plan participants nearing retirement to contribute more to their retirement accounts and allow plan participants of any age to take advantage of the benefits of tax-deferred earnings over a longer period of time.

Required minimum distributions: The legislation would allow individuals to delay tapping into their retirement account savings by increasing the age for beginning required minimum distributions from a qualified plan or IRA to 73 (from 72 under current law) beginning in 2022, and raising it gradually thereafter until it reaches 75 in 2032. The proposal would be effective for distributions required to be made after December 31, 2021, for employees and IRA owners who reach age 72 after that date.

Qualified plan catch-up contributions: Under current law, participants in a section 401(k) plan, section 403(b) plan, or governmental section 457(b) plan who are aged 50 or older generally may make additional annual catch-up contributions of up to $6,500 (the inflation-adjusted amount in effect for 2021). A $3,000 annual catch-up limit (indexed) applies for eligible participants in a Savings Incentive Match Plan for Employees (SIMPLE plan). This legislation generally would increase the catch-up contribution amount to $10,000 ($5,000 for SIMPLE plans) for participants who reach age 62, 63, or 64 during a taxable year. (Both amounts would be indexed annually for inflation.) The provision would be effective for taxable years beginning after December 31, 2022.

IRA catch-up contributions: IRA holders aged 50 and older are permitted under current law to make additional catch-up contributions of up to $1,000 a year, but that limitation is not subject to a cost-of living adjustment. This legislation would adjust the $1,000 cap annually for inflation (in $100 increments) for taxable years beginning in 2023 or later.

Expanding retirement coverage

The legislation also includes provisions intended to expand the universe of workers that participate in employer-sponsored retirement plans.

Automatic enrollment: Sponsors of certain new 401(k), 403(b) and SIMPLE plans generally would be required to automatically enroll employees in those plans as soon as they become eligible to participate, although employees would be allowed to opt out. The employee contribution rate would be at least 3 percent during the first year of participation and would automatically increase by 1 percentage point each year until it reaches at least 10 percent (but no more than 15 percent) unless the employee specifically opts out of contributing or elects a different percentage.

Grandfathering rules would apply for plans already in effect on the date of enactment, and exceptions would apply for businesses with 10 or fewer employees, businesses that have been operating for fewer than three years, church plans, and governmental plans.

The proposal would be effective for plan years beginning after December 31, 2022.

A separate provision would provide a safe harbor for employers to correct reasonable administrative errors in implementing an automatic enrollment or automatic escalation feature, subject to certain conditions. This provision would apply to any errors with respect to which the date that is nine and one-half months after the end of the plan year during which the error occurred is after the date of enactment.

Targeted participation provisions: In addition to the broad proposal to provide for automatic retirement plan enrollment, the legislation includes several proposals to increase retirement plan participation rates among specific segments of the workforce who, for various reasons, may find it too difficult to contribute to an employer-sponsored plan.

- **Student loan payments treated as elective deferrals:** To assist younger workers who may lack the disposable income to save for retirement while they are paying down student loan debt, the legislation would allow employers to treat student loan payments as elective deferrals for purposes of determining employer matching contributions to an employer-sponsored retirement plan, effective for plan years beginning after December 31, 2021.
- **Credit for small employers hiring military spouses:** To assist military spouses, whose frequent moves can make it difficult for them to comply with length-of-service requirements for participating in an employer-sponsored retirement plan and the vesting rules for employer matching contributions, the legislation would provide a tax credit to certain small employers who (1) make military spouses eligible to participate in the plan within two months of hire, (2) offer them immediate eligibility for employer matching contributions equal to those that otherwise would have been available after two years of employment, and (3) provide immediate 100 percent vesting of matching contributions. The credit would apply for three years for each military spouse hired but would be limited to nonhighly compensated employees. This provision would be effective for taxable years beginning after the date of enactment.
- **Reduced service requirement for part-time workers:** To bring more long-term part-time workers into the retirement system, the legislation would require an employer to allow part-time employees to participate in the employer's defined contribution plan if an employee has worked for the employer at least 500 hours a year for at least two continuous years and has reached the age of 21 by the end of the two-consecutive-year period. (Under the SECURE Act, the length-of-service requirement is three years.) This provision generally would be effective as if enacted in section 112 of the SECURE Act.

Start-up credit for small employers: Current law provides a three-year credit to defray administrative costs for small employers (those with 100 or fewer employees) who establish new retirement savings plans. The credit amount is 50 percent, capped at $5,000 a year. The Ways and Means-approved bill would expand the credit for the smallest businesses by increasing the credit rate to 100 percent for those with up to 50 employees. It also would increase the credit for certain eligible employers who make matching contributions on behalf of their employees. (The increased credit amount would be based on the rate of the employer's matching contribution and would be phased down over five years before being reduced to zero. Additional limitations on the credit would apply to employers with more than 50 and fewer than 100 employees.) These provisions would be effective for taxable years beginning after December 31, 2021.

The legislation also would clarify that in the case of an employer that joins an already existing pension plan, the first credit year is the taxable year which includes the date that the eligible employer plan to which such costs relate becomes effective with respect to the eligible employer. This provision would apply to eligible employer plans which become effective with respect to the eligible employer after the date of enactment.

Section 403(b) plan enhancements: The legislation would broaden the availability of section 403(b) defined contribution plans – particularly among smaller employers – by permitting 403(b) sponsors to participate in a multiple employer plan (MEP) arrangement. These MEP 403(b) arrangements generally would follow the provisions governing other MEP defined contribution plans laid out in the SECURE Act – including relief from the "one bad apple" rule, so that violations by one plan sponsor participating in a MEP would not affect the tax-qualified status of other plans participating in the arrangement. The provision generally would be effective for plan years beginning after December 31, 2021.

A separate provision would clarify that contributions to a section 403(b) plan that are held in a custodial account are treated as contributions to an annuity contract if the assets are to be held in that custodial account and invested in regulated investment company stock or a group trust intended to satisfy the requirements of Rev. Rul. 81-100 (or any successor guidance), effective for amounts invested after December 31, 2021.

Promoting retirement plan participation: The legislation would eliminate a current-law rule that prevents employers from offering small, immediate financial incentives – such as a gift card in a *de minimis* amount – to encourage employees to participate in the employer's retirement plan, effective for plan years beginning after the date of enactment.

It also would require the Treasury Department to launch a campaign to increase public awareness of the current-law Saver's Credit and provide a report to Congress summarizing anticipated promotion efforts, effective for tax years beginning after the date of enactment.

Changes to retirement plan rules

The Ways and Means-approved bill includes a number of changes to the retirement plan design rules that are intended to ease administration burdens for plan sponsors and provide additional flexibility and other relief for plan participants.

Plan sponsors: Proposed changes intended to simplify plan administration would:

- Provide that, in the case of certain overpayments from defined benefit and defined contribution plans, a plan will not lose its qualified status (or be deemed in violation of the requirements of sections 401 and 403) merely because it fails to obtain repayment on account of any inadvertent benefit overpayment made by the plan, or the plan sponsor amends the plan in a certain manner to adjust for prior inadvertent benefit overpayments. This provision would be effective on the date of enactment.
- Require the Secretary of Labor to modify existing regulations on fiduciary duties under section 404 of the Employee Retirement and Income Security Act (ERISA) with respect to "designated investment alternatives" that contain a mix of asset classes to provide that, in certain specified instances, a plan administrator may – but is not required to – use a benchmark which is a blend of different broad-based securities market indices (effective on the date of enactment).
- Require the Secretary of the Treasury and the Secretary of Labor, along with the Pension Benefit Guarantee Corporation (PBGC), to review the ERISA-required reporting and disclosure requirements that apply to pension plans and qualified retirement plans, and to report to Congress on certain specified matters, including recommendations on potential consolidations and/or simplifications of such reporting requirements (effective on the date of enactment).

- Exempt defined contribution plans from requirements to provide disclosures and other plan documents to unenrolled participants, as long as those unenrolled participants receive an annual notice reminding them of their eligibility to participate in the plan (effective for plan years beginning after December 31, 2021).
- Expand the scope of the Employee Plans Compliance Resolution System (EPCRS) to provide that any "eligible inadvertent failure" – as defined in the bill – to comply with rules applicable to certain qualified retirement plans may be self-corrected under the EPCRS. Self-correction would not be available, however, if the failure was identified by the Secretary of the Treasury prior to actions being taken to implement a self-correction (effective on the date of enactment). In addition, the bill would authorize the expansion of EPCRS to cover certain issues that arise in IRAs.
- Provide, consistent with comparable rules applicable to section 401(k) and 403(b) plans, that compensation can be deferred under a section 457(b) plan maintained by a governmental employer if an agreement providing for that deferral was entered into prior to the compensation being made available to the individual, no longer requiring such an agreement be entered into during the calendar month prior to when the compensation was earned (effective for taxable years beginning after the date of enactment).
- Modify the rules under ERISA to require defined contribution plans to provide at least one benefit statement in paper form to participants during each calendar year and require defined benefit plans to provide at least one benefit statement in paper form to participants every three years (effective for plan years beginning after December 31, 2022).
- Relax the "top-heavy" rules for certain defined contribution plans in instances where the plan satisfies the top-heavy minimum contribution requirement with respect to employees who do not meet other requirements related to minimum age and service (effective for plan years beginning after the date of enactment).
- Modify the family attribution rules that apply in determining whether two or more employers are to be aggregated for purposes of applying the qualification rules, by providing that the family attribution rules will be applied without regard to any community property laws (effective for plan years beginning on or after the date of enactment).
- Allow amendments to stock bonus, pension, and other plans to increase benefits accrued under the plan for the preceding plan year, provided the amendment is adopted prior to the time prescribed by law (including extensions) for the filing of the employer's tax return for the taxable year during which the amendment is effective, similar to the rule that allows retroactive plan amendments to comply with tax qualification requirements (effective for plan years beginning after December 31, 2022).
- Provide that, with respect to so-called "hardship distributions," a plan administrator may rely on an employee's certification that a distribution is on account of a financial need specified in the related Treasury regulations (effective for plan years beginning after December 31, 2021).

Participant-focused provisions: Among the proposed changes for individuals, the legislation includes a provision that would index the annual $100,000 exclusion limit for qualified charitable distributions from retirement plans, and allow a one-time election to make such a distribution (of up to $50,000, indexed for inflation) to a "split-interest entity" such as a charitable remainder annuity trust or a charitable remainder unitrust. This provision would be effective for distributions made in taxable years ending after the date of enactment.

Other proposed changes benefitting individuals would:

- Allow certain sole proprietors to treat elective deferrals to newly established section 401(k) plans as having been made before the end of the plan's first plan year provided the elective deferral is made by the individual prior to the time for filing his or her individual tax return, determined without extensions (effective for plan years beginning after the date of enactment).
- Reduce the excise tax – from 50 percent to 25 percent – that generally applies to the shortfall by which an individual's distributions during the year from a qualified retirement plan are less than the amount otherwise required under the required minimum distribution rules. The excise tax would be reduced further, to 10 percent, for individuals who correct the shortfall within a specified "correction window" and submit a return reflecting the excise tax. The measure also would clarify the statute of limitations on these excise taxes. These provisions would be effective for taxable years beginning after December 31, 2021.
- Limit the period for recontributing a qualified birth or adoption distribution to an eligible retirement plan to three years from the day after the date of distribution (effective as if enacted in section 113 of the SECURE Act).
- Expand the exception that generally grants "qualified public safety employees" in governmental plans relief from the otherwise applicable "early withdrawal tax" to private-sector firefighters. As a result, such individuals could take distributions from a qualified plan after reaching age 50 and separating from service, rather than the 59-1/2 age threshold that applies generally (effective for distributions made after December 31, 2021).
- Provide for an exclusion from gross income for certain "qualified first responder retirement payments" up to an annualized threshold (effective for tax years beginning after 2026).
- Provide an exception to the usual 10 percent early withdrawal penalty tax in the case of eligible distributions to domestic abuse victims and allow for recontributions of such amounts at any time after the distribution was received (effective for distributions made after the date of enactment).
- Provide that, in the case of the excise tax imposed on excess contributions to an IRA, the three-year statute of limitations with respect to tax liability will begin to run when the related income tax return is filed and not when Form 5329 is filed, as under current law (effective on the date of enactment).
- Modify the disqualification rules that apply when an IRA owner or beneficiary engages in a prohibited transaction to provide that the portion of the IRA that is treated as having been distributed to the individual is limited to the portion that was used in the prohibited transaction (effective for taxable years beginning after the date of enactment).
- Establish a "Retirement Savings Lost and Found" database, managed by the PBGC, containing certain information related to unclaimed vested benefits of missing, lost, and nonresponsive participants and beneficiaries with the aim of allowing such participants and beneficiaries to locate plans from which they may be owed benefits (various effective dates would apply).

Annuity provisions

The legislation proposes to remove barriers to offering certain types of annuity products within a defined contribution plan.

Life annuities: The bill would amend the required minimum distribution regulations to permit commercial annuities within a defined contribution plan to offer features such as guaranteed annual payment increases, return of premium death benefits, period-certain guarantees, and dividends or similar distributions determined in an actuarially reasonable manner. This provision would be effective as of the date of enactment.

QLACs: The legislation would modify current regulations regarding the treatment of qualifying long-term annuity contracts (QLACs) to (1) eliminate the requirement that premiums for QLACs be limited to 25 percent (or any other percentage) of an individual's account balance), (2) clarify the treatment of QLACs purchased with joint survivor and annuity benefits for an individual and his or her spouse, and (3) ensure that the regulation does not preclude a contract from offering a provision that allows an employee to rescind the purchase of a contract within up to 90 days from the date of purchase (the "short free look period"). This provision generally would be effective with respect to contracts purchased or received in an exchange on or after the date of enactment. The changes with respect to joint and survivor annuities and the "short free look period" would be effective with respect to contracts purchased or received in an exchange on or after July 2, 2014.

Insurance-dedicated exchange-traded funds: The bill would direct the Treasury Department to revise the regulations on diversification requirements for variable annuity contracts under section 817(h) to facilitate the use of exchange-traded funds under variable contracts. The provisions would be effective for segregated asset account investments made on or after the date that is seven years after the date of enactment.

SECURE Act technical amendments

A technical amendment to the SECURE Act would clarify that the provision that increased the age for beginning required minimum distributions to 72 does not change the general requirement to actuarially increase the accrued benefit of an employee (other than a 5 percent owner) who retires in a calendar year after the year the employee reaches age 70-1/2. (This is intended to take into account the period after age 70-1/2 in which the employee was not receiving any benefits under the plan.)

A separate technical amendment would clarify that the excise tax on excess contributions to an IRA generally does not apply to "difficulty of care payments" contributed to an IRA. (The SECURE Act provides that these nontaxable payments to certain home health care workers are treated as compensation for qualified plan and IRA contribution purposes.)

Both amendments would be effective as if included in the section of the SECURE Act to which the amendment relates.

Administrative provisions

The Ways and Means-approved bill provides that plan amendments made pursuant to the changes in this legislation (or pursuant to implementing regulations issued by the Treasury Department) may take effect retroactively. For this treatment to apply, the plan must be operated as if the plan amendment were in effect, and the amendment must be made on or before the last day of the first plan year beginning on or after January 1, 2023 (or the date prescribed in any Treasury regulations). In the case of a governmental plan, the amendment would be required to be made on or before the last day of the first plan year beginning on or after January 1, 2025 (or the date prescribed in any Treasury regulations).

The provision would also extend the time for adopting plan amendments necessary to reflect changes made by the SECURE Act. In addition, if an employer implemented the special loan or distribution provisions of the Coronavirus Aid, Relief, and Economic Security (CARES) Act (P.L. 116-36) within its plan, or the waiver of required minimum distributions also as permitted by the CARES Act, the deadline to adopt the plan amendments necessary to reflect these provisions would be extended from the last day of the first plan year beginning on or after January 1, 2022 to the last day of the first plan year beginning on or after January 1, 2023. A similar extension would be provided for amendments necessary to reflect the Taxpayer Certainty and Disaster Relief Act of 2020. For governmental plans, the deadline for adopting amendments for the provisions of the SECURE Act and CARES Act that require a plan amendment would be extended to the last day of the first plan year beginning after January 1, 2025.

This provision would be effective on the date of enactment.

Revenue offsets: Expanded 'Rothification'

On the revenue side, the legislation would raise an estimated $27.4 billion over 10 years – chiefly through provisions that would expand "Roth" treatment of certain retirement accounts and certain retirement account contributions. ("Roth"-style retirement accounts, named for former Senate Finance Committee Chairman William Roth, R-Del., require contributions to be made with after-tax funds rather than on a pre-tax basis, with distributions paid out tax-free during retirement.)

The Ways and Means-approved offsets would:

- Require a section 401(a) qualified plan, section 403(b) plan, or governmental section 457(b) plan that permits an eligible participant to make catch-up contributions to treat those contributions as after-tax Roth contributions. The proposal would not apply to a SIMPLE IRA or Simplified Employee Pension (SEP) plan. This provision would be effective for taxable years beginning after December 31, 2021.
- Allow participants in a section 401(a) qualified plan, a section 403(b) plan, or a governmental 457(b) plan to designate employer matching contributions as Roth contributions. An employer matching contribution that is a designated Roth contribution would not be excludable from gross income. This provision would be effective for contributions made after the date of enactment.

- Permit SEPs and SIMPLE IRAs to be designated as Roth IRAs, with contributions made with after-tax income and distributions excludable from gross income. Roth treatment of a SEP or SIMPLE IRA would be subject to an employee's election. The contribution limit for Roth IRAs generally would be increased by the contributions made on the individual's behalf to the SIMPLE IRA or SEP for the taxable year, subject to certain limits. This provision would be effective for taxable years beginning after December 31, 2021.

Hardship withdrawal rules for section 403(b) plans: The legislation also would conform the hardship distribution rules for section 403(b) plans to those of section 401(k) plans. As a result, in addition to elective deferrals, a section 403(b) plan would be permitted to distribute, on account of an employee's hardship, qualified nonelective contributions, qualified matching contributions, and earnings on any of these contributions (including on elective deferrals). This provision would be effective for plan years beginning after December 31, 2021.

Views and estimates letter approved

In other developments at the May 5 mark-up, House taxwriters approved a "views and estimates" letter for fiscal year 2022 identifying the committee's legislative priorities for those areas of the federal budget that fall within its jurisdiction.
URL:
https://waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/FY22%20VE%20Letter%20Final.pdf

The letter, which is required under the Congressional Budget Act of 1974, will be sent to the House Budget Committee as that panel gets ready to develop its fiscal year 2022 budget resolution in the coming weeks. (Other House committees will send their own views and estimates letters to the Budget panel outlining their respective legislative priorities.)

On tax policy, the Ways and Means letter broadly restates the Biden administration's legislative agenda, noting that the panel will "examine policies that deliver more inclusive economic growth that supports and grows America's middle class," including "infrastructure investment, retirement savings, workforce development, access to higher education, …small business growth, and…administration of the tax laws by the Internal Revenue Service."

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