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Secure Act 2.0's Litany of Retirement Change Presents Employers Enhanced Retirement Opportunities for Employees

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The SECURE Act 2.0 of 2022 (''SECURE 2.0'' or the ''Act'') became law as part of the Consolidated Appropriations Act of 2023. SECURE 2.0 builds on the Setting Every Community Up for Retirement Enhancement Act of 2019 (i.e., the ''SECURE Act''), signed into law in December 2019, to improve retirement savings opportunities for workers.

SECURE 2.0 tries to accomplish three primary goals: (i) get people to save more for retirement; (ii) improve retirement rules; and (iii) lower the employer cost of setting up a retirement plan. Through these goals SECURE 2.0 allows employers to enhance the retirement savings of employees by incentivizing employee savings at a decreased cost.

Specifically, SECURE 2.0 amends the Internal Revenue Code of 1986 (''Code'') and the Employee Retirement Income Security Act of 1974, as amended

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(“ERISA”), to modify certain rules for retirement plans and tax-favored savings accounts.

Several provisions serve to reduce revenues significantly — for example, by expanding automatic enrollment in retirement plans and raising the age at which required minimum distributions (RMDs) from defined contribution retirement plans or traditional individual retirement arrangements (IRAs) must begin. Other provisions would increase revenues — by directing some retirement plans to require catch-up contributions to be designated as taxable Roth contributions and allowing some plans to permit employees to designate their employers' matching contributions as Roth contributions.

While plan amendments generally need not be made until the end of the first plan year beginning on or after January 1, 2025, plans must be operated in accordance with the effective date of each new provision. Following are highlights of key provisions, organized by the same headings used in the Act.

EXPANDING COVERAGE AND INCREASING RETIREMENT SAVINGS

Expansion of Automatic Enrollment in Retirement Plans

New 401(k) and 403(b) plans must automatically enroll participants in the plans when they become eligible (and employees may opt out of coverage). The initial automatic enrollment amount is at least 3% but not more than 10%; each year thereafter that amount is increased by 1% until it reaches at least 10% but not more than 15%. This requirement becomes effective for plan years beginning after December 31, 2024.

Note: All 401(k) and 403(b) plans in effect on the date of enactment are grandfathered, and there is an exception to this requirement for small businesses with 10 or fewer employees, new businesses (i.e., those that have been in business for less than three years), church plans and governmental plans.

Modification of Credit for Small Employer Pension Plan Startup Costs

The Act makes the following changes to the three-year small employer startup tax credit:

- Increases the startup credit from 50% to 100% for employers with up to 50 employees.
- Further increases the amount of the startup credit by the applicable percentage of employer contributions made on behalf of employees, up to a per-employee cap of $1,000. Contributions for employees with wages over $100,000 (as indexed) are disregarded. The full amount of the additional credit is limited to employers with 50 or fewer employees and is phased out for employers with between 51 and 100 employees. The applicable percentage (beginning with the year in which the plan is established) is 100% in the first and second years, 75% in the third year, 50% in the fourth year, 25% in the fifth year, and no credit for tax years thereafter.

Note: This additional credit does not apply to employer contributions made: (i) as elective deferrals as defined in Internal Revenue Code §402(g)(3); or (ii) to a defined benefit plan under Code §414(j).) These changes apply to taxable years beginning after December 31, 2022.

Application of Tax Credit for Small Employer Pension Plan Startup Costs to Employers That Join an Existing Plan

The Act includes measures to ensure that the three-year small employer startup tax credit is available to employers joining multiple employer plans (“MEPs,” which include pooled employer plans or “PEPs”), regardless of how long the MEP has been in existence.

Note: The startup tax credit only applies for the first three years of a plan's existence. For example, where a plan that has been in existence for more than three years joins a MEP, the startup credit is not available.

Saver's Match replaces Saver's Credit. Current law allows for a nonrefundable credit (*i.e.*, a Saver's Credit) for certain individuals who make contributions to IRAs and employer retirement plans (*e.g.*, 401(k) plans). The Act repeals and replaces the Saver's Credit, changing it from a credit paid in cash as part of a tax refund into a federal matching contribution that must be deposited into a taxpayer's IRA or retirement plan. The amount of the match is 50% of IRA or retirement plan contributions, up to $2,000 per individual. The match is subject to an income-based phase out and becomes effective for tax years beginning after 2026.

Pooled Employer Plans modified. ERISA is amended to require Pooled Employer Plans to designate a named fiduciary (other than an employer in the plan) to be responsible for collecting plan contributions and to implement collection procedures.

Increase in age for required beginning date for mandatory distributions. The original SECURE Act

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increased the required minimum distribution age to 72. Accordingly, under current law, participants are generally required to begin taking distributions from their retirement plans at age 72. The 2.0 Act increased the RMD age to 73 starting January 1, 2023, and increases it again to age 75 starting on January 1, 2033.

Higher catch-up limit to apply at age 60, 61, 62 and 63. The current limit on catch-up contributions to a retirement plan is $6,500, except in the case of SIMPLE plans for which the limit is $3,000. The Act increases the catch-up contribution limit for retirement plans to the greater of $10,000 or 50% more than the regular catch-up amount applicable in 2025 for individuals who have attained age 60 but not age 64 before the close of the taxable year. The increased limits take effect for taxable years beginning after December 31, 2024, and are indexed for inflation after 2025.

Treatment of student loan payments as elective deferrals for purposes of matching contributions. The Act authorizes employers to make matching contributions under a 401(k) or 403(b) plan, or a SIMPLE IRA on employees' qualified student loan payments. Governmental employers are permitted to make matching contributions in a Code §457(b) plan or another plan with respect to such student loan payments. Under the Act, "qualified student loan payment" is broadly defined as any indebtedness incurred by the employee solely to pay qualified higher education expenses of the employee. The Act requires employees who receive such matching contributions to certify annually to the employer that such payment has been made on such loan. This provision applies to contributions made for plan years beginning after December 31, 2023.

> *Note*: The Act confirms that for purposes of the Code's nondiscrimination rules: (i) student loan payments will not be treated as plan contributions; and (ii) a plan may separately test the employees who receive matching contributions on student loan payments in determining whether it satisfies the Actual Deferral Percentage testing requirements for a given plan year.

Small immediate financial incentives for contributing to a plan. Current law prohibits immediate financial incentives (other than matching contributions), such as gift cards in small amounts, to encourage participants to participate in 401(k) and 403(b) plans. Effective for plan years beginning after 2022, the Act enables employers to offer de minimis financial incentives, such as low-dollar gift cards, to incentivize employee participation in 401(k) and 403(b) plans by exempting these de minimis benefits from the Code's contingent benefit provisions, so long as such incentives are not paid from plan assets. This section of the Act also amends the prohibited transaction sections of both the Code and ERISA.

Deferral of tax for certain sales of employer stock to employee stock ownership plans sponsored by S corporations. A popular tax deferral technique is the sale of shares of a non-publicly held C corporation to an employee stock ownership plan, if the ESOP owns at least 30% of the employer corporation's stock and the sales proceeds are invested in qualified replacement property. For sales made after December 31, 2027, the gain deferral provisions are extended to S corporations, with respect to not more than 10% of the amount realized on the sale both for purposes of determining gain and the extent to which (if at all) the amount realized on the sale exceeds the cost of the qualified replacement property

Withdrawals for certain emergency expenses. While there are a number of statutory exceptions, distributions from a tax-qualified plan or IRA prior to the individual's attaining age 59½ are subject to a 10% tax. The Act provides an additional exception for certain distributions used for emergency expenses that are unforeseeable or related to personal or immediate family needs. In general, plan administrators will be allowed to rely upon a participant's self-certification, although IRS has the authority to issue guidance to address situations in which a plan administrator has actual knowledge to the contrary or there are employee misrepresentations. Only one distribution, not to exceed $1,000, is permitted each year, and a taxpayer can repay the distribution within three years. However, no further emergency distributions are permissible during the three-year repayment period, unless repayment occurs. This provision of the Act is effective for distributions made after 2023.

Exemption for certain automatic portability transactions. Under present law, if a separated participant's account balance or accrued benefit is between $1,000 and $5,000 (the Act will increase this amount to $7,000) and the participant does not make an affirmative election with respect to his or her distribution, it can be rolled over into a default IRA. For transactions occurring 12 months or more after the date of enactment, the Act adds a new prohibited transaction exemption that permits a retirement plan service provider, subject to several conditions including acknowledgment of fiduciary status, to provide a plan with automatic portability services. These services would include the automatic transfer of a plan participant's default IRA into the retirement plan of the participant's new employer.

Starter 401(k) plan for employers with no retirement plans. Effective for plan years beginning after 2023, the Act permits an employer that does not sponsor a retirement plan to offer a starter deferral-only

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401(k) plan or a safe harbor 403(b) plan. Such a plan would generally require that all employees be default-enrolled into the plan at a 3% to 15% of compensation deferral rate. The limit on annual deferrals would be the same as the IRA deferral limit for the year. Catch-up contributions would be permitted. Such plans would not be treated as top-heavy.

Improving coverage for part-time workers. One of the significant benefit plan provisions of the SECURE Act was the liberalization of the Code's eligibility and vesting requirements for long-term, part-time employees in 401(k) plans. In addition to providing relief from several nondiscrimination requirements, the SECURE Act provided that, except in the case of collectively bargained plans, 401(k) plans must have a dual eligibility requirement: either one year of service with a 1,000-hour rule, or three consecutive years of service with a 500 hours of service requirement. The Act modifies these provisions in three ways. First, effective for plan years beginning after 2024, the three-year rule is reduced to two years. Second, pre-2021 service is disregarded for vesting purposes, just as pre-2021 service is disregarded for eligibility purposes, to the same extent as if the provision was included in the SECURE Act. Third, the SECURE Act provision is extended to 403(b) plans that are subject to ERISA.

Emergency savings accounts linked to individual account plans. The Act provides employers with the option to offer pension-linked emergency savings accounts to their non-highly compensated employees, defined in the same manner as for tax-qualified plans (for 2024, employees who receive 2023 compensation in excess of $150,000, and for 2023 employees who receive 2022 compensation in excess of $135,000 are highly compensated). These accounts will be part of the plan document but accounted for separately. Employers may automatically opt their employees into these accounts at no more than 3% of salary with a cap on contributions of $2,500 or a lower dollar amount as determined by the employer. Once the dollar cap is reached, the amounts can be contributed to a Roth defined contribution plan, or stopped until the amount drops below the dollar cap. These additional contributions are treated as elective deferrals for purposes of matching contributions, with a cap of $2,500 or the lesser amount chosen by the employer. At an employee's separation from service, the employee can receive the contribution in cash or roll it into an IRA.

Enhancement of 403(b) plans. Except for retirement account plans of churches, 403(b) plan participants are generally limited to investing in annuity contracts or publicly traded mutual funds. The amendment permits 403(b) plan custodial accounts to participate in group trusts (such as CITs) with other tax-preferred savings vehicles. While this provision is effective after the date of enactment, because of securities law issues, 403(b) plans will not be offering investments in collective trusts immediately.

PRESERVATION OF INCOME

Qualifying Longevity Annuity Contracts (QLACs). QLACs are generally deferred annuities that begin payments towards the end of an individual's life expectancy. Because the IRS previously lacked authority under the Code to provide a full exemption from the Code's required minimum distribution rules for QLACs, their use has been limited. The Act addresses this limitation by repealing the ceiling of 25% of the participant's account balance and allowing more than $200,000 (indexed) to be used from an account balance. This provision is effective immediately, and the IRS is directed to update its regulations dealing with QLACs within 18 months of the Act's enactment.

SIMPLIFICATION AND CLARIFICATION OF RETIREMENT PLAN RULES

Recovery of retirement plan overpayments. The Act gives retirement plan fiduciaries discretion to decide not to recoup overpayments mistakenly made to retirees. Where a plan's fiduciaries do choose to recoup overpayments, the Act subjects their collection efforts to certain limitations and protections to safeguard retirees. Rollovers of the overpayments remain valid. This provision becomes effective immediately.

Reduction in excise tax on certain accumulations in qualified retirement plans. The Act reduces the excise tax penalty for failing to take a required minimum distribution from 50% to 25%. If the failure relates to an IRA and is rectified in a timely manner (as defined in the Act), the excise tax on the failure is further reduced from 25% to 10%. This provision becomes effective for tax years after 2022.

Retirement savings lost and found. The Act calls for the Secretary of Labor (in consultation with the Secretary of the Treasury) to create and establish a national online searchable "lost and found" database for U.S.-based retirement plans. The purpose of the database is to enable retirement savers, who may have lost track of their pension or 401(k) plan, to obtain the contact information of their plan administrator. The creation of the database is to occur no later than two years after the enactment of the Act.

Updating dollar limit for mandatory distributions. Current law allows employers to "cash out" former employees from a workplace retirement plan into an IRA if their account balances are between $1,000 and $5,000. The Act increases the cashout limit from $5,000 to $7,000, effective for distributions made after 2023.

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Expansion of Employee Plans Compliance Resolution System. The Act modifies the IRS's Employee Plans Compliance Resolution System to: (i) allow more types of errors to be rectified internally through self-correction; (ii) apply to inadvertent IRA errors; and (iii) exempt certain failures to make required minimum distributions from the otherwise applicable excise tax penalty. Notably, the Act allows for the correction of many plan-loan errors through the self-correction process. This provision is effective immediately.

Employer may rely on employee certifying that deemed hardship distribution conditions are met. The Act provides that, for purposes of taking a hardship withdrawal, under certain circumstances employees are permitted to self-certify that they have experienced an event that qualifies as a financial hardship. This provision becomes applicable for plan years beginning after 2022.

Exception to penalty on early distributions from qualified plans for individuals with a terminal illness. Under existing law, a 10% excise tax penalty generally applies to early distributions made from tax-preferred retirement accounts. The Act provides an exception to this tax penalty in the case of a distribution made to a terminally ill individual. This relief becomes effective for distributions made after the enactment of the Act.

Penalty-free withdrawal from retirement plans for individual cases of domestic abuse. The Act authorizes retirement plans to allow participants who self-certify that they have experienced domestic abuse to withdraw a small amount of money (the lesser of $10,000, indexed for inflation, or 50% of the participant's account balance). The Act further provides: (i) the distribution is not subject to the otherwise applicable 10% excise tax penalty on early distributions; and (ii) the participant has the opportunity to repay the withdrawn money from the plan over three years and will be refunded income taxes on money that is repaid. This provision applies to distributions made after 2023.

Requirement to provide paper statements in certain cases. The Act amends ERISA to require defined contribution plans to provide participants with at least one paper benefit statement annually (one every three years for defined benefit plan participants), unless a participant affirmatively requests electronic delivery. In addition to summarizing the participant's benefits, the paper statement must contain information on how participants can opt out of receiving the paper disclosure or request delivery of some or all disclosures on paper for no additional cost. This requirement becomes effective for plan years after 2025.

Note: This change wouldn't apply to benefit statements furnished electronically to current employees under DOL's 2002 regulatory safe harbor for e-delivery.

Application of top-heavy rules to defined contribution plans covering excludible employees. Discrimination tests applicable to 401(k) plans permit separate testing of non-excludable and excludible employees (employees under age 21 or who have not completed a year of service). However, this type of testing has not been available in connection with a plan's top-heavy testing. As a result, small employers may not cover otherwise excludible employees, due to concerns that the presence of those individuals for top-heavy testing may result in the need to make a 3% nonelective contribution if the plan is found to be top-heavy. The Act addresses this issue for plan years beginning after 2023 by allowing employers to perform top-heavy plan testing separately for non-excludible and excludible employees.

Repayment of qualified birth or adoption distributions limited to three years. A technical glitch in the original SECURE Act permitted a qualified birth or adoption distribution to be recontributed to a retirement plan at any time and be treated as a rollover. The 2.0 Act amends the qualified birth and adoption distribution rules to provide for a repayment period of three years, effective for such distributions made after the effective date of the Act and retroactively to the three-year period beginning on the day after the date on which such a distribution was received.

Retroactive first year elective deferrals for sole proprietors. The original SECURE Act modified a long-standing tax rule by allowing an employer to establish a new plan, including a 401(k) plan, after the end of the employer's tax year, but before the employer's tax filing due date, and to treat the plan as having been established on the last day of the taxable year. The 2.0 Act allows such plans, when they are sponsored by sole proprietors or single member LLCs, to receive employee contributions up until the employee's tax return filing due date.

Eliminating certain unnecessary plan requirements related to unenrolled participants. Effective for plan years beginning after 2022, unenrolled plan participants who have received a summary plan description in connection with their initial eligibility under the plan and any other required notices related to eligibility are not required to receive intermittent Code or ERISA notices.

Performance benchmarks for asset allocation funds. Under the DOL's participant disclosure regulations, the historical investment performance of each of a plan's designated investment alternatives must be compared to an appropriate broad-based securities market index. However, these regulations do not adequately address asset allocation funds such as target

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date funds, which are frequently the qualified default investment alternative of plans providing participant-directed accounts. The Act directs DOL, within two years of the enactment of the Act, to update its regulations so that an investment that uses a mix of asset classes can be benchmarked against a blend of broad-based securities market indices.

Roth plan distribution rules. Under current law, pre-death required minimum distributions are required in the case of the owner of a designated Roth account in an employer retirement plan such as a 401(k) plan. The Act eliminates the pre-death RMD requirement for Roth accounts in employer plans, effective for tax years beginning after 2023.

Special rules for use of retirement funds in connection with qualified federally declared disasters. With respect to federally declared disasters occurring on or after January 26, 2021, the Act provides permanent rules relating to the use of retirement funds.

Long-term care contracts purchased with retirement plan distributions. Effective three years after the date of enactment, the Act permits plans to distribute up to $2,500 per year to pay premiums for high-quality long-term care insurance products. These distributions are exempt from the 10% additional tax on early distributions.

Annual audits for group of plans. The Act clarifies that any plan filing under a group of plans, as provided by the SECURE Act, needs to submit an audit opinion if it has 100 participants or more. As a result, DOL and IRS would continue to receive full audit information on the same number of plans as under current law. Plans with fewer than 100 participants that are included in a group of plans would not be required to submit an audit opinion.

Safe harbor for correction of employee elective deferral failures. Under EPCRS, IRS has issued guidance on the correction of failures resulting from automatic enrollment and automatic escalation. The IRS guidance includes a safe harbor that is scheduled to expire at the end of 2023. To address employer concerns about the lapse of the safe harbor at the end of 2023, effective for errors occurring after December 31, 2023, the Act allows for a grace period to correct, without penalty, reasonable errors in administering automatic enrollment and automatic escalation features. However, these errors must be corrected within 9½ months after the end of the plan year in which the mistakes were made.

ADMINISTRATIVE PROVISIONS

Provisions relating to plan amendments. Plan amendments made to comply with the Act must be adopted by the end of the 2025 plan year (2027 in the case of governmental plans). Amendments must reflect the effective date of the statutory change, and a plan must be operated in accordance with the statutory change, starting on the statutory effective date.

REVENUE PROVISIONS

Elective deferrals generally limited to regular contribution limit. Current law allows a plan sponsor to permit catch-up contributions to be made to a qualified retirement plan on either a pre-tax or Roth (*i.e.*, after-tax) basis. Effective for taxable years beginning after 2023, the Act requires all catch-up contributions to a qualified retirement plan to be Roth contributions.

> *Note*: The Act provides an exception to this requirement for employees with compensation of $145,000 or less (indexed for inflation).

Optional treatment of employer matching or nonelective contributions as Roth contributions. Under current law, plan sponsors could not provide either employer matching contributions or nonelective contributions in their 401(k), 403(b) and governmental 457(b) plans on a Roth basis. Plan sponsors were required to make these contributions on a pre-tax basis only. Effective immediately, the Act authorizes defined contribution plan sponsors to provide participants with the option of receiving matching contributions and nonelective contributions on a Roth basis.

CONCLUSION

SECURE 2.0 is nearly 400 pages in length, addressing many disparate provisions. Some are technical in nature, many are non-controversial, and some represent significant improvements that have been requested for a long period of time.

Employers have an opportunity to increase retirement plan participation through design changes that will allow employees to save more for retirement and strengthen retirement plans all with decreased costs for small employers and decreased administrative burdens for all employer plan sponsors.

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