Understanding SECURE 2.0

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Important Dates

- Consolidated Appropriations Act, 2023
- Passed Congress 12/23/2022
- Signed by President, Date of Enactment – Dec 29, 2022
- Division T – SECURE Act 2.0

Expanding automatic enrollment in retirement plans

- Section 101 requires 401(k) and 403(b) plans to automatically enroll participants in the respective plans upon becoming eligible (and the employees may opt out of coverage).
    - The initial automatic enrollment amount is at least 3 percent but not more than 10 percent.
    - Each year thereafter that amount is increased by 1 percent until it reaches at least 10 percent, but not more than 15 percent.
    - **<u>All current 401(k) and 403(b) plans (plans established before Dec 29, 2022) are grandfathered</u>**.
    - There is an exception for small businesses with 10 or fewer employees, new businesses (i.e., those that have been in business for less than 3 years), church plans, and governmental plans.
- Section 101 is effective for plan years beginning after December 31, 2024.

Credit for small employer pension plan startup costs

- The 3-year small business startup credit is currently 50 percent of administrative costs, up to an annual cap of $5,000.
- Section 102 makes changes to the credit by increasing the startup credit from 50 percent to 100 percent for employers with up to 50 employees.
- Except in the case of defined benefit plans, an additional credit is provided.
  - The amount of the additional credit generally will be a percentage of the amount contributed by the employer on behalf of employees, up to a per-employee cap of $1,000.
  - This full additional credit is limited to employers with 50 or fewer employees and phased out for employers with between 51 and 100 employees.
  - The applicable percentage is 100 percent in the first and second years, 75 percent in the third year, 50 percent in the fourth year, 25 percent in the fifth year – and no credit for tax years thereafter.
- Section 102 is effective for taxable years beginning after December 31, 2022.

Application of credit for plan startup costs to employers which join an existing plan

Section 111 ensures the startup tax credit is available for 3 years for employers joining a MEP, regardless of how long the MEP has been in existence.

- Under both pre- and post-SECURE Act law, the startup tax credit only applies for the first 3 years that a plan is in existence. For example, if a small business joins a MEP that has already been in existence for 3 years, the startup credit is not available. If, for example, the MEP has been existence for 1 or 2 years when a small business joins, the small business may be able to claim the credit for 1 or 2 years, respectively.
- Section 111 fixes this issue so that employers joining a MEP (which includes PEPs) are eligible for the credit for all 3 years.

Section 111 is effective retroactively for taxable years beginning after December 31, 2019.

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Saver's Match

- Current law provides for a nonrefundable credit for certain individuals who make contributions to individual retirement accounts ("IRAs") and employer retirement plans (401(k), 403(b) plans).
- Section 103 repeals and replaces the credit with respect to IRA and retirement plan contributions, 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 match is 50 percent of IRA or retirement plan contributions up to $2,000 per individual.
  - The match phases out between:
    - $41,000 and $71,000 in the case of taxpayers filing a joint return,
    - $20,500 to $35,500 for single taxpayers and married filing separate;
    - $30,750 to $53,250 for head of household filers.
- Section 103 is effective for taxable years beginning after December 31, 2026.

Saver’s Match

Where does the match come from?

- “Payable by the Secretary (of the Treasury) as soon as practicable after the eligible individual has filed a tax return making a claim for such matching contribution for the taxable year”

Where does the match go?

- To the “applicable retirement savings vehicle” chosen by the participant.
  - 401(k), 403(b), 457(b), IRA
  - Plan may choose not to accept the Saver’s Match
  - If amount under $100, participant can take as a credit
- Fully vested
- Not subject to statutory limits or nondiscrimination testing, e.g., 402(g), 415, ADP, Top heavy

MEP and PEP 403(b) plans

Multiple employer plans ("MEPs") provide an opportunity for small employers to band together to obtain more favorable retirement plan investment results and more efficient and less expensive management services.

Section 106 allows 403(b) plans to participate in MEPs and PEPs, including relief from the one bad apple rule so that the violations of one employer do not affect the tax treatment of employees of compliant employers.

Section 106 is effective for plan years beginning after December 31, 2022

Increase in age for required beginning date for mandatory distributions

- Under current law, participants are generally required to begin taking distributions from their retirement plans at age 72.
  - The policy behind this rule is to ensure that individuals spend their retirement savings during their lifetime and not use their retirement plans for estate planning purposes to transfer wealth to beneficiaries.
  - The SECURE Act of 2019 increased the required minimum distribution age to 72.
- Section 107 further increases the required minimum distribution age further to 73 starting on January 1, 2023 – and increases the age further to 75 starting on January 1, 2033.

Increase in age for required beginning date for mandatory distributions

Date of birth	Required beginning date (Apr 1st following year)
7/1/1949 – 12/31/1950	Age 72
1/1/1951 – 12/31/1959	Age 73
On or after 1/1/1960	Age 75

Reduction in excise tax on certain accumulations in qualified retirement plans on MRD failures

Section 302 reduces the penalty for failure to take required minimum distributions from 50 to 25 percent.

Further, if a failure to take a required minimum distribution from an IRA is corrected in a timely manner, as defined under this Act, the excise tax on the failure is further reduced from 25 percent to 10 percent.

Section 302 is effective for taxable years beginning after the date of enactment of this Act.

Individual retirement plan statute of limitations for excise tax on MRD failures

- Under current law, the statute of limitations for excise taxes imposed on MRD failures starts running as of the date that Form 5329 is filed for the violation.
  - Individuals often are not aware of the requirement to file Form 5329, and this can lead to an indefinite period of limitations that can cause hardship for taxpayers due to the accumulation of interest and penalties (see Paschall v. C.I.R., 137 T.C. 8 (2011)).
  - In order to provide finality for taxpayers in the administration of these excise taxes, Section 313 provides that a 3 year period of limitations begins when the taxpayer files an individual tax return (Form 1040) for the year of the violation.
  - In general, this change is intended to ensure that there is a reasonable period of limitations for violations of which taxpayers were not aware and thus did not file an excise tax return.
- Section 313 is effective on the date of enactment of this Act.

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Higher catch-up limit to apply at age 60, 61, 62, and 63

- Under current law, employees who have attained age 50 are permitted to make catch-up contributions under a retirement plan in excess of the otherwise applicable limits. The limit on catch-up contributions for 2023 is $7,500.
- Section 109 increases these limits to the greater of $10,000 or 50 percent more than the regular catch-up amount in 2025 for individuals who have attained ages 60, 61, 62 and 63.
  - The increased amounts are indexed for inflation after 2025.
- Section 109 is effective for taxable years beginning after December 31, 2024.

Treatment of student loan payments as elective deferrals for purposes of matching contributions

- Intended to help employees who may not be able to save for retirement because they are overwhelmed with student debt, and thus are missing out on available matching contributions for retirement.
- Section 110 permits an employer to make matching contributions under a 401(k) plan, 403(b) plan, or SIMPLE IRA with respect to "qualified student loan payments."
  - A qualified student loan payment is broadly defined as any indebtedness incurred by the employee solely to pay qualified higher education expenses of the employee.
  - Employee must annually certify student loan payment; Employer may rely on certification.
  - Governmental employers are also permitted to make matching contributions in a section 457(b) plan or another plan with respect to such repayments.
- Plan may treat student loan payment as an elective deferral for purposes of safe harbor, QACA or SIMPLE plans.
- For purposes of the ADP nondiscrimination test, Section 110 permits a plan to test separately the employees who receive matching contributions on student loan repayments.
- Effective for plan years beginning after December 31, 2023.

Small immediate financial incentives for contributing to a plan

- Under current law, immediate financial incentives for employees to contribute to a 401(k) or 403(b) plan (like gift cards in small amounts) are prohibited even though individuals may be especially motivated by them to join their employers' retirement plans.
- Section 113 enables employers to offer de minimis financial incentives, <u>not paid for with plan assets</u>, such as low-dollar gift cards, to boost employee participation in workplace retirement plans.
- Section 113 is effective for plan years beginning after the date of enactment of this Act.

Withdrawals for certain emergency expenses

- Generally, an additional 10 percent tax applies to early distributions from tax-qualified retirement accounts.
- Section 115 provides an exception for certain distributions used for emergency expenses, which are unforeseeable or immediate financial needs relating to personal or family emergency expenses.
    - Only one distribution is permissible per year of up to 1,000,
    - The taxpayer has the option to repay the distribution within 3 years.
    - No further emergency distributions are permissible during the 3 year repayment period unless repayment occurs.
- Section 115 is effective for distributions made after December 31, 2023.

Nontrade or business SEP contributions

Section 118 permits employers of domestic employees (e.g., nannies) to provide retirement benefits for such employees under a Simplified Employee Pension (“SEP”).

Section 118 is effective for taxable years beginning after date of enactment of this Act.

Coverage for long-term part-time ("LTPT") workers

- The SECURE Act requires employers to allow long-term, part-time workers to participate in the employers' 401(k) plans.
- The SECURE Act provision provides that – except in the case of collectively bargained plans – employers maintaining a 401(k) plan must have a dual eligibility requirement under which an employee must complete either 1 year of service (with the 1,000-hour rule) or 3 consecutive years of service (where the employee completes at least 500 hours of service).
- Section 125 <u>reduces the 3 year rule to 2 years</u>, effective for plan years beginning after December 31, 2024.
- Pre-2021 service is disregarded for vesting purposes, just as such service is disregarded for eligibility purposes under current law, effective as if included in the SECURE Act to which the amendment relates.
- This provision also extends the long-term part-time coverage rules to 403(b) plans that are subject to ERISA.

Coverage for long-term part-time ("LTPT") workers

- 2024 plan year – apply SECURE 1.0 rules
  - 3-year eligibility rule
- 2025 plan year – apply new SECURE 2.0 rules
  - 2-year eligibility
- Example:
  - Plan year beginning 1/1/2024, must cover LTPT employees who have completed 3 years of service (500 – 999 hours)
    - Count hours of service during 2021, 2022 and 2023.
  - Plan year beginning 1/1/2025, must cover LTPT employees who have completed 2 years of service (500 – 999 hour)
    - Count hours of service during 2023 and 2024

Emergency savings accounts in individual account plans

- Employers may automatically opt employees into these accounts at no more than 3 percent of their salary, and the portion of an account attributable to the employee's contribution is capped at $2,500 (or lower as set by the employer).
  - Once the cap is reached, the additional contributions can be directed to the employee's Roth defined contribution plan (if they have one) or stopped until the balance attributable to contributions falls below the cap.
  - Contributions are made on a Roth basis and are treated as elective deferrals for purposes of retirement matching contributions with an annual matching cap set at the maximum account balance – i.e., $2,500 or lower as set by the plan sponsor.
  - Match goes into match account (not ESA).
  - The first four withdrawals from the account each plan year may not be subject to any fees or charges solely on the basis of such withdrawals.
  - At separation from service, employees may take their emergency savings accounts as cash or roll it into their Roth defined contribution plan (if they have one) or IRA.
  - NHCEs only. If NHCE becomes an HCE, no further contributions to ESA.
  - Investment limited to capital preservation or interest-bearing account.

Enhancement of 403(b) plans – CITs

Under current law, 403(b) plan investments are generally limited to annuity contracts and publicly traded mutual funds.

This limitation cuts off 403(b) plan participants – generally, employees of charities and public schools, colleges, and universities– from access to collective investment trusts, which are often used by 401(k) plans to expand investment options for plan participants at a lower overall cost.

Section 128 would permit 403(b) custodial accounts to participate in group trusts with other tax-preferred savings plans and IRAs, and would be effective after date of enactment

Enhancement of 403(b) plans – CITs

Revisions to the securities laws are required to permit 403(b) plans to invest in CITs.

Qualifying longevity annuity contracts

QLACs are deferred annuities that begin payment at the end of an individual's life expectancy.

- Because payments start so late, QLACs are an inexpensive way for retirees to hedge the risk of outliving their savings in defined contribution plans and IRAs.
- Section 202 repeals the 25 percent limit and allows up to $200,000 (indexed) to be used from an account balance to purchase a QLAC.
- Section 202 also facilitates the sales of QLACs with spousal survival rights – and clarifies that free-look periods are permitted up to 90 days with respect to contracts purchased or received in an exchange on or after July 2, 2014.

Section 202 is effective for contracts purchased or received in an exchange on the date of enactment of this Act, and the Treasury Secretary must update the relevant regulations within 18 months of the date of enactment of this Act.

Recovery of retirement plan overpayments

- Section 301 allows retirement plan fiduciaries the discretion to decide not to recoup overpayments that were mistakenly made to retirees.
- If plan fiduciaries choose to recoup overpayments, limitations and protections apply to safeguard innocent retirees.
- Rollovers of the overpayments also remain valid.
- Section 301 is effective on the date of enactment of this Act, and further outlines how plan fiduciaries may proceed with respect to determinations made prior to the date of enactment of this Act to seek or not to seek recovery of overpayments.

Higher dollar limit for mandatory distributions

- Under current law, employers may transfer former employees’ retirement accounts from a workplace retirement plan into an IRA if their balances are between $1,000 and $5,000.
- Last changed in 1997.
- Section 307 increases the limit from $5,000 to $7,000 (not indexed), effective for distributions made after December 31, 2023.

Remove required minimum distribution barriers of life annuities

- Section 201 eliminates certain barriers to the availability of life annuities in qualified plans and IRAs that arise under current law due to an actuarial test in the required minimum distribution regulations.
  - The test is intended to limit tax deferral by precluding commercial annuities from providing payments that start out small and increase excessively over time.
  - In operation, however, the test commonly prohibits many important guarantees that provide only modest benefit increases under life annuities.
    - For example, guaranteed annual increases of only 1 or 2 percent, return of premium death benefits, and period certain guarantees for participating annuities are commonly prohibited by this test.
    - Without these types of guarantees, many individuals are unwilling to elect a life annuity under a defined contribution plan or IRA.
- Section 201 is effective for calendar years ending after the date of enactment of this Act.

Expansion of Employee Plans Compliance Resolution System

- Because of the ever-growing complexity of retirement plan administration, Section 305 expands the Employee Plans Compliance Resolution System ("EPCRS") to
  - Allow more types of errors to be corrected internally through self-correction,
  - Apply to inadvertent IRA errors, and
  - Exempt certain failures to make required minimum distributions from the otherwise applicable excise tax.
- For example, Section 305 allows for correction of many plan loan errors through self-correction, which are a frequent area of error and can be burdensome to correct a single loan error through the Internal Revenue Service.
- Section 305 is effective on the date of enactment of this Act.
- Any guidance or revision of guidance required by Section 305 shall be promulgated no later than 2 years after the date of enactment of this Act.
- Revenue Procedure 2021–30 (or any successor guidance) shall be updated to take into account the provisions of this section no later than 2 years after the date of enactment of this Act.

Application of top heavy rules to defined contribution plans covering excludable employees

- Plans that are deemed top-heavy are required to provide employees with a minimum of a 3 percent of pay nonelective contribution.
- Other nondiscrimination tests that apply to 401(k) plans allow an employer to test otherwise excludable employees (e.g., those who are under age 21 and have less than 1 year of service) separately.
  - This was intended to encourage plan sponsors to permit employees to defer earlier than the minimum age and service conditions permitted under the law because it reduces the situations where plans would fail the nondiscrimination tests if these employees were included when performing the test.
  - However, this separate testing is not allowed for the top-heavy test. As a consequence, small employer retirement plans often do not cover excludable employees because, if the plan is or becomes top heavy, the employer ise required to contribute the top- heavy employer contribution for all employees who are eligible to participate in the plan.
  - Section 310 allows an employer to perform the top-heavy test separately on the non-excludable and excludable employees.
  - This removes the financial reason to exclude employees from the 401(k) plan.
- Section 310 is effective for plan years beginning after December 31, 2023.

Repayment of qualified birth or adoption distribution limited to 3 years

- The SECURE Act included a provision that allows participants to withdraw distributions from their retirement plan in the case of birth or adoption without paying the 10 percent additional tax under Code section 72(t).
- The distributions can be repaid to a retirement plan at any time and are treated as rollovers.
- The problem with current law is the allowance of repayment at any time. Code section 6511 prevents a refund from being provided to a taxpayer after the period of limitations for the return has closed, which is generally a 3-year period. Thus, there is not a way for someone who took a QBAD distribution to repay the distribution more than 3 years later and amend their return to receive a refund for the taxes that were paid in the year of the withdrawal.
- Section 311 amends the QBAD provision to restrict the repayment period to 3 years.
- Section 311 is effective to distributions made after the date of the enactment of this Act and retroactively to the 3 year period beginning on the day after the date on which such distribution was received.

Employer may rely on employee certifying that deemed hardship distribution conditions are met

Employees are permitted to self-certify that they have had an event that constitutes a hardship for purposes of taking a hardship withdrawal.

- Distribution is on account of immediate and heavy financial need under safe harbor regulations
- Distribution does not exceed the amount of need
- Employee does not have other resources

Current hardship rules already permit employees to self-certify that they do not have other funds available to address a hardship.

Section 312 is effective for plan years beginning after the date of enactment of this Act.

Hardship distributions from 403(b) plans

Allows 403(b) hardship distributions to be administered same as 401(k) hardships.

- Deferrals
- QNECs, QMACs, Safe Harbor contributions
- Earnings

No requirement to take loan first.

Amendment to increase benefits under plan for previous plan year allowed until employer tax return due date

- Current law provides that plan amendments must generally be adopted by the last day of the plan year in which the amendment is effective.
- This precludes an employer from adding plan provisions that may be beneficial to participants.
- Section 316 allows discretionary amendments that increase participants' benefits to be adopted by the due date of the employer's tax return.
- Section 316 is effective for plan years beginning after December 31, 2023.

Use of retirement funds in connection with qualified federally declared disasters

- Section 331 provides permanent rules relating to the use of retirement funds in the case of a federally declared disaster.
- The permanent rules allow up to $22,000 to be distributed from employer retirement plans or IRAs for affected individuals.
  - Such distributions are not subject to the 10 percent additional tax and are taken into account as gross income over 3 years.
  - Distributions can be repaid to a tax-qualified retirement account.
  - Amounts distributed prior to the disaster to purchase a home can be recontributed, and an employer is permitted to provide for a larger amount to be borrowed from a plan by affected individuals and for additional time for repayment of plan loans owed by affected individuals.
- Section 331 is effective for disasters occurring on or after January 26, 2021.

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Employers allowed to replace SIMPLE retirement accounts with safe harbor 401(k) plans during a year

Under current law, the employer is stuck with the SIMPLE IRA for entire year.

Section 332 allows an employer to replace a SIMPLE IRA plan with a Safe Harbor 401(k) plan that requires mandatory employer contributions during a plan year.

- SIMPLE 401(k), QACA, or Safe Harbor plans

Deferral dollar limit is prorated (by days) between SIMPLE and 402(g) dollar limits

Effective for plan years beginning after December 31, 2023.

Safe harbor for corrections of employee elective deferral failures

- Under current law, employers that adopt a retirement plan with automatic enrollment and automatic escalation features could be subject to significant penalties if even honest mistakes are made.
- The Internal Revenue Service has issued guidance on the correction of failures relating to default enrollment of employees into retirement plans.
- This guidance includes a safe harbor, which expires December 31, 2023, that permits correction if notice is given to the affected employee, correct deferrals commence within certain specified time periods, and the employer provides the employee with any matching contributions that would have been made if the failure had not occurred.
- Employers are concerned about the lapse of the safe harbor at the end of 2023.
- Section 350 eases these concerns by allowing for a grace period to correct, without penalty, reasonable errors in administering these automatic enrollment and automatic escalation features.
- Errors must be corrected prior to 9 ½ months after the end of the plan year in which the mistakes were made.
- Section 350 is effective to errors after December 31, 2023.

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Catch up contributions must be Roth

Under current law, catch-up contributions to a qualified retirement plan can be made on a pre-tax or Roth basis (if permitted by the plan sponsor).

Section 603 provides all catch-up contributions to qualified retirement plans are subject to Roth tax treatment, effective for taxable years beginning after December 31, 2023.

An exception is provided for employees with prior year compensation of $145,000 or less (indexed).

Optional treatment of employer matching or nonelective contributions as Roth contributions

Under current law, plan sponsors are not permitted to provide employer matching or nonelective contributions in their 401(k), 403(b), and governmental 457(b) plans on a Roth basis.

Matching and nonelective contributions must be on a pre-tax basis only.

Section 604 allows defined contribution plans to provide participants the option of receiving matching or nonelective contributions on a Roth basis.

Presumably follow rules for Roth deferrals.

Effective on the date of enactment of this Act.

Provisions relating to plan amendments

1

Plan amendments made pursuant to this Act must be made on or before the last day of the first plan year beginning on or after January 1, 2025 (2027 in the case of governmental plans).

2

The plan must operate in accordance with such amendments as of the effective date of the amendment.

3

Section 501 also conforms the plan amendment dates under the SECURE Act, the CARES Act, and the Taxpayer Certainty and Disaster Tax Relief Act of 2020 to these new dates (instead of 2022 and 2025).

Thank You