VOL 11: SECURE 2.0

At Long Last, SECURE 2.0 Is Here

As we counted down the final days of 2022, the U.S. Congress passed one last bill before the holiday recess. The omnibus spending bill H.R.2617 - Consolidated Appropriations Act, 2023 contained more than 90 provisions relating to retirement plan savings, the long-awaited SECURE 2.0.

SECURE 2.0 contains provisions designed to:

- Make it easier and more cost-effective for small businesses to offer a retirement plan
- Encourage all employees to take advantage of their employer's retirement plan
- Change the rules for employees who are approaching retirement age
- Make retirement plans more flexible to address the diverse needs of savers at any age

President Biden signed the bill into law on December 29, 2022, though most of SECURE 2.0 is not scheduled to take effect until later years. This gives the Internal Revenue Service (IRS) and the Department of Labor time to issue regulations to help us understand and implement these provisions. It also gives employers plenty of time to consider which optional changes will be most helpful to their participants.

Here is our summary of the most significant elements of SECURE 2.0.

Provisions Designed to Encourage Employers to Adopt 401(k)s

Enhancing the current tax credit for adopting a retirement plan – Under current law, employers with fewer than 100 employees that adopt a new retirement plan may qualify for an annual tax credit for up to three years equal to the lesser of 50% of administrative start-up costs or $5,000. Effective for 2023, SECURE 2.0 increases the percentage from 50% to 100% for employers with 50 or fewer employees.

SECURE 2.0 also provides a new tax credit for the contributions employers make to a new retirement plan (other than a defined benefit plan). The new tax credit will be a set percentage of the amount contributed by the employer as an employer contribution (as opposed to salary deferrals) for employees with annual compensation of $100,000 or less, up to a per-employee cap of $1,000.

The set percentage is:

Plan Year	Percentage
Year plan is established	100
Year 2	100
Year 3	75
Year 4	50
Year 5	25
All later years	0

The full amount of the new tax credit will be available to employers with 50 or fewer employees but phases out for employers with 51 to 100 employees.

New "starter" 401(k)/403(b) plan for employers with no retirement plan – Effective for plan years beginning after 2023, SECURE 2.0 will allow an employer that does not sponsor a retirement plan to offer a new "starter 401(k) deferral-only arrangement" or "403(b) safe harbor plan." These plans generally will require all employees to be automatically enrolled in the plan at a 3% to 15% deferral rate. The limit on annual deferrals will be the same as the individual retirement account (IRA) contribution limit ($6,000 with an additional $1,000 in catch-up contributions beginning at age 50 for 2022). These plans will not be subject to the top-heavy rules.

First-year retroactive salary deferrals for sole proprietors – Sole proprietors are eligible to establish a special type of 401(k) plan, known as a "Solo K." Under the original SECURE Act passed in 2020 (SECURE 1.0), for the first year the plan was established, the sole proprietor could contribute employer contributions (but not salary deferrals) for the first plan year retroactively, so long as the contributions were made as of the due date for the business's return.

Effective immediately, SECURE 2.0 allows a sole proprietor to make salary deferral contributions to a Solo K for the year the plan is established retroactively, up until the business tax filing deadline.

Employers can transition from SIMPLE IRA to a 401(k) plan mid-year – Under current law, an employer that sponsors a SIMPLE IRA program for its employees may not terminate the SIMPLE arrangement mid-year, even if the intent is to sponsor a (more generous) 401(k) plan. Additionally, employees who participate in a SIMPLE IRA program must wait for two years from the date they first began participating in the SIMPLE IRA program before they can roll over those assets to a different IRA or a qualified retirement plan other than another SIMPLE IRA program.

Effective for plan years beginning after December 31, 2023, an employer may elect to replace a SIMPLE IRA plan with a safe harbor 401(k) plan at any time during the year, provided certain requirements are met. Additionally, the two-year holding period does not apply to transfers from the employer's old SIMPLE IRA program to the new 401(k) plan.

Provisions Designed to Increase Employee Participation

Mandatory automatic enrollment and automatic escalation for new plans – Currently, plan sponsors may choose to offer automatic enrollment and automatic escalation as features of their retirement plan, but they are not required to do so.

SECURE 2.0 requires all newly established 401(k) and 403(b) plans to have an eligible automatic contribution arrangement (EACA) feature. This includes automatic enrollment at a default rate of between 3% and 10% with a 90-day unwind feature and automatic escalation of 1% per year up to a maximum of at least 10%, but no more than 15%. This requirement becomes effective for plan years beginning after December 31, 2024.

This new provision will not apply to governmental plans, church plans, small employers with 10 or fewer employees, SIMPLE plans, new employers that existed for less than three years, or existing plans established before the date of enactment.

Modification of Saver's Credit – Effective for tax years beginning after December 31, 2026, lower-income retirement savers will be eligible to receive a government-funded matching contribution to their IRA or retirement plan in an amount up to 50% of their contributions (phased out as the individual's income increases), capped at a maximum of $2,000 and reduced by certain distributions taken by the individual.

De minimis incentives to boost employee participation – Employers looking to boost retirement plan participation sometimes consider offering small incentives (i.e., a gift card for a free lunch or cup of coffee) to employees who enroll in the retirement plan. Current law, however, prohibits employees from receiving incentives or other benefits (other than matching contributions) for making contributions to a retirement plan.

Effective for plan years after the date of enactment, SECURE Act 2.0 loosens this restriction and allows employers to provide "de minimis financial incentives" that are not paid for with plan assets. The statute does not include any guidance on what constitutes a de minimis financial incentive, which presumably will be left to guidance from the IRS.

Changes to part-time employee participation rule – Under SECURE 1.0, 401(k) plans generally must permit an employee to contribute to a plan if the employee worked at least 500 hours per year with the employer for at least three consecutive years and has met the minimum age requirement (age 21) by the end of the three-consecutive-year period. In the case of employees who are eligible solely by reason of the rule for long-term, part-time employees, the employer may elect to exclude such employees from the nondiscrimination testing and coverage rules and the application of the top-heavy vesting and benefit rules, and such an employer is not required to make matching or nonelective contributions to such employees. Twelve-month periods beginning before January 1, 2021, are disregarded for purposes of its special eligibility rule for long-term, part-time employees (but not for vesting purposes).

SECURE 2.0 reduces the required years of service before long-term, part-time workers are eligible to contribute to a plan from three to two. Pre-2021 service is also disregarded for purposes of the vesting of employer contributions, and pre-2023 service is disregarded for eligibility and vesting purposes under the new SECURE 2.0 part-time employee provision. SECURE 2.0 also extends the long-term, part-time coverage rules to 403(b) plans subject to ERISA. These changes are effective for plan years beginning after 2024.

New Rules for Employees Approaching Retirement Age

Increase in RMD age to 75 – Before January 1, 2020, the age at which RMDs were required to begin was 70½. SECURE 1.0 raised this age to 72. SECURE 2.0 again increases the RMD age to 73 for a person who attains age 72 after December 31, 2022, and age 73 before January 1, 2033, and 75 for an individual who attains age 74 after December 31, 2032.

Higher catch-up limits for ages 60-63 – Currently, individuals age 50 and over are allowed to make catch-up contributions to 401(k), 403(b), governmental 457(b) and SIMPLE plans, and the annual catch-up contribution limits are generally indexed for inflation. For 2023, catch-up contributions are limited to $7,500.

SECURE 2.0 increases the limit on catch-up contributions for individuals age 60-63 to the greater of $10,000 or 150% of the regular catch-up amount for 2024, indexed for inflation.

Catch-up contributions must be made on a Roth basis – Under current law, employees eligible to make catch-up contributions make them on either a pre-tax or Roth basis.

SECURE 2.0 requires that catch-up contributions to Section 401(a) qualified plans, Section 403(b) plans and governmental Section 457(b) plans must be made on a Roth basis, except for eligible participants whose prior year wages do not exceed $145,000 (indexed for inflation). This requirement does not apply to SIMPLE IRAs or SEP plans.

Roth accounts in retirement plans no longer subject to RMDs – Under current law, Roth accounts in qualified retirement plans are subject to the required minimum distribution (RMD) rules, while Roth IRAs are not. SECURE 2.0 changes the rule so that Roth amounts held in qualified plans are treated the same as Roth IRAs, and no distributions are required during the participant's lifetime.

Changes That Will Provide Greater Financial Flexibility to Retirement Savers of All Ages

Allowing $1,000 emergency withdrawal penalty free – Effective for withdrawals made after December 31, 2023, certain withdrawals or distributions from certain eligible retirement plans, such as 401(k) and 403(b) plans, for emergency expenses will not be subject to the 10% tax on early distributions. Only one emergency expense withdrawal of up to a maximum of $1,000 is permissible each year. The participant must be allowed to repay the withdrawal within the following three years. Additional emergency expense withdrawals within the three-year period are limited if repayment has not been made or additional contributions have not been made equal to or exceeding the repayment amount.

Plan-linked savings accounts – SECURE 2.0 permits employers to offer "pension-linked emergency savings accounts" within their 401(k) plans to which non-highly compensated employees can contribute. The maximum account value will be $2,500. Contributions that exceed $2,500 will spill over to the long-term retirement savings portion of the plan. Employers can even opt to automatically enroll participants in these savings arrangements at a rate of up to 3% of pay. Contributions are made on a Roth basis. This option becomes available in 2024.

Student loan provisions – Effective for plan years beginning after 2023, 401(k), 403(b) and nongovernmental 457(b) plan sponsors can make matching contributions to employees for certain "qualified student loan payments" made by the employees for higher education expenses and to have these matching contributions treated as regular matching contributions for discrimination testing purposes. This provision is intended to make it easier for employers to provide employer-matching contributions to employees who are paying off student loans in lieu of making retirement plan contributions.

Optional Roth treatment for employer-matching and nonelective contributions – Current law does not permit employer matching or nonelective contributions to be made on a Roth basis. SECURE 2.0 allows a Section 401(a) qualified plan, a Section 403(b) plan or a governmental 457(b) plan to permit employees to designate employer matching or nonelective contributions as Roth contributions. Student loan matching contributions may also be designated as Roth contributions. Matching and nonelective contributions designated as Roth contributions are not excludable from the employee's income and must be 100% vested when made.

Special distribution/loan provision for federally declared disasters – Before SECURE 2.0, when a natural disaster happened, Congress and the IRS provided ad hoc relief from the retirement plan rules. The form of relief varied according to the specific incident, and there was no guarantee any relief would be granted until the legislation was passed or the guidance was formally issued.

Effective for disasters occurring on or after January 26, 2021, SECURE Act 2.0 establishes permanent rules for such relief, permitting up to $22,000 in "qualified disaster recovery distributions" that are not subject to the 10% tax on early distributions. Qualified disaster recovery distributions are eligible to be taken into income over three years and can be repaid to the plan. In addition, for individuals who experience a qualified disaster, the maximum plan loan limit can be increased up to $100,000 (or 100% of the participant's account balance, if less), and a one-year extension of any loan repayment period can be provided.

We're Here to Help

Keeping up with new regulations and critical deadlines for retirement plans can be time-consuming if you're a busy plan sponsor. Definiti hopes to save you time (and stress) by keeping you apprised of the legislative landscape with timely, informative *Insights* articles and quarterly ERISA Connection updates from our legal team. Questions about SECURE 2.0? Contact your RPC, call 1-(888)-912-3653 or email sales@definiti-llc.com.