What You Need to Know About SECURE 2.0

A Summary of Key Provisions for Plan Sponsors and Administrators

Mindi M. Johnson, Julie L. Hamlet and Amanda J. Dernovshek

Foster Swift Business & Tax Law News

February 23, 2023

AUTHORS/ CONTRIBUTORS
Amanda J. Dernovshek
Julie LaVille Hamlet
Mindi M. Johnson

PRACTICE AREAS
Employee Benefits
Employer Services

On December 29, 2022, the sweeping retirement plan legislation commonly referred to as SECURE 2.0 (the "Act") was enacted. It provided welcome relief and new opportunities for Plan Sponsors keen to promote their 401(k) and Profit Sharing Plans as valuable benefits to their employees. A summary of the Act's key provisions is provided below. The provisions are organized according to their mandatory, permissive, or administrative nature in an effort to assist in focusing your attention on the provisions that are most likely to affect your plan.

A. Mandatory Changes. There are several mandatory changes required by the Act that will affect all plans. Those changes are itemized below.

a. Required Minimum Distributions - Age Increase
Current law requires that distributions from qualified retirement plans must begin (for non-employee owners) by April 1st following the later of the calendar year in which the employee attains age 72 or retires. The Act increases the age that triggers a required minimum distribution to: age 73 starting on January 1, 2023; and age 75 starting on January 1, 2033. *Foster Swift Collins & Smith (FSCS) Insight: This change will provide participants with greater flexibility to manage their own retirement strategies.*

b. Involuntary Distributions - Dollar Limit Increase

Under current law, a plan may distribute a participant's account balance without the participant's consent if the account balance does not exceed \$5,000. The Act will increase the involuntary cash-out limit from \$5,000 to \$7,000, effective for distributions made after December 31, 2023. *FSCS Insight: This change will help employers reduce the administrative burden associated with maintaining small balance accounts for former employees.*

c. Age 50 Catch-Up Contribution Changes

Current law permits individuals age 50 and over to make additional catch-up contributions (above the general elective deferral limit) to certain retirement plans. The 2023 annual catch-up limit for most plans is $7,500. Catch-up contributions currently may be made on a pre-tax or Roth basis.

The Act makes the below changes to the catch-up contribution rules:

1. All catch-up contributions will be made on a Roth basis, except those made by participants whose wages do not exceed $145,000 (as annually indexed for inflation). This change applies for taxable years beginning after December 31, 2023, but does not apply to SIMPLE IRAs or SEP plans. *FSCS Insight: This change may come as a surprise to some participants and should be clearly communicated.*
2. The annual catch-up limit for individuals aged 60-63 will increase to the greater of (i) $10,000 or (ii) 50% more than the regular catch-up amount in 2024, indexed for inflation. This change applies for taxable years beginning after December 31, 2024, and will be different for SIMPLE plans. *FSCS Insight: This change will provide participants with greater flexibility to manage their own retirement strategies.*

d. <u>401(k) Inclusion of Long-term, Part-time Employees- Expanded Eligibility</u>

Current law requires (in 2024) that 401(k) plans must permit long-term, part-time employees to make elective deferrals if such employees worked at least 500 hours per year for at least three consecutive years and attained age 21 by the end of the three-consecutive-year period.

The Act reduces the service requirement for long-term, part-time employees from three years to two years, effective for plan years beginning after December 31, 2024. The Act also extends the long-term, part-time coverage rules to 403(b) plans. *FSCS Insight: These changes will result in expanded eligibility for these long-term part-time employees.*

e. <u>Distribution to Firefighters</u>

Under current law, public sector firefighters are permitted to terminate employment at age 50 and take distributions from a retirement plan without triggering the 10% penalty for early distributions.

The Act extends this age 50 rule to private sector firefighters, effective December 29, 2022. *FSCS Insight: This change provides additional tax relief for certain private sector employees.*

f. <u>Automatic Enrollment and Escalation Require - New Plans Only</u>

Under current law, a plan sponsor may provide eligible employees with a choice to either "opt in" to plan participation or "opt out." Under the "opt in" approach, eligible employees may choose whether or not to make deferrals to the plan and, if so, the amount to defer. Under the "opt out" approach, eligible employees are automatically enrolled in the plan and required to defer a specific percentage of compensation unless they "opt out."

The Act requires that most new 401(k) or 403(b) plans include an automatic enrollment feature that meets certain requirements. Such a feature would automatically enroll eligible newly hired employees at a pretax contribution level of at least 3% and not more than 10% of the employee's pay. This contribution level would increase annually by 1% up to at least 10% but not more than 15% of the employee's pay. Employees may affirmatively elect a different contribution and may withdraw automatically contributed funds within 90 days if certain requirements are met. This requirement applies to plans established after December 31, 2024. *FSCS Insight: This change will increase plan participation (and their retirement savings) but should be clearly communicated to participants. It also increases exposure to potential plan errors. Attention to administration and enrollment is essential to avoid potential penalties.*

B. Permissive Changes. In addition to mandatory changes, the Act allows Plan sponsors to adopt a number of permissive changes. We outline some of the more significant permissive changes below.

a. Penalty-Free Withdrawals

Under current law, an individual who is younger than age 59 ½ is generally required to pay a 10% penalty on the taxable amount of distributions that he or she takes from certain retirement accounts. However, the 10% penalty does not apply in all situations. For example, it does not apply with regard to distributions made to a beneficiary after the death of the participant or distributions triggered by the participant’s disability (among other exceptions).

The Act adds new exceptions, identified below, that allow participants to receive distributions without being assessed the 10% penalty on early distributions. If such a distribution is taken, the individual will have three years to repay the distribution (and receive a refund of income taxes paid). These exceptions will be available for distributions made after December 31, 2023 (unless otherwise stated). *FSCS Insight: This change will provide participants with greater flexibility to manage their own retirement strategies.*

1. *Emergencies*. Distributions due to unforeseen or immediate financial need in relation to personal or family emergency expenses. A penalty-free distribution of up to $1,000 may be taken, but no further distributions will be permitted during that three-year period.
2. *Victims of Domestic Violence*. Distributions to participants who self-certify that they are victims of domestic violence. A penalty-free distribution of up to the lesser of $10,000 (indexed for inflation) or 50% of the participant’s account may be taken.
3. *Terminally Ill Participants*. Distributions to participants who have a terminal illness. Under the Act, terminal illness means an illness or physical condition that can be reasonably expected to result in death within seven years or less. This type of illness must be certified by a physician and the timeframe during which this distribution provision applies is 84 months from the date of the physician’s certification. This provision is effective as of December 29, 2022.

4. *Federally Declared Disasters*. The Act also modified the distribution rules related to federally declared disasters. Under the new law, if a participant is impacted by a federally declared disaster, he or she can request to withdraw up to $22,000 from an employer-sponsored retirement plan or IRA. The distribution would not be subject to the typical 10% early withdrawal tax and the amount may be repaid to a tax-deferred retirement account. In addition to the distribution permitted as a result of the federally declared disaster, the Act allows an employee to recontribute funds that were previously taken to purchase a home to their retirement account. The changes also allow an employer to provide for a larger distribution amount and a longer repayment term (an additional year) for affected individuals. Depending on the demographics of your plan participants, this may be a design provision worth considering. This is effective for disasters occurring on or after January 26, 2021.

b. <u>Optional Treatment of Employer Matching or Nonelective Contributions as Roth Contributions</u>

Under current law, employer contributions (e.g., matching and/or profit-sharing contributions) made on behalf of plan participants must be made on a pre-tax basis only.

The Act modifies this rule to permit a plan participant to designate some or all of the employer contributions made on his or her behalf as Roth, after-tax contributions. One caveat to this rule, however, is that the participant must be fully vested in the contributions if such contributions are designated as Roth. Such designations may apply to contributions made after December 29, 2022. *FSCS Insight: This change will provide participants with greater flexibility to manage their own retirement and tax strategies.*

c. <u>Matching Contributions Made on Student Loan Repayments</u>

Under current law, employer matching contributions may only be made on behalf of a participant who makes elective deferrals to the plan. In recent years, the Internal Revenue Service ("IRS") has opined that it may be proper for an employer to make matching contributions on behalf of participants who do not make elective deferrals but who do make student loan repayments.

The Act formalizes the IRS guidance and permits an employer to make matching contributions with respect to "qualified student loan payments." (A qualified student loan payment is a payment applied toward debt incurred by the employee solely to pay his or her qualified higher education expenses.) Essentially, payments made towards student debt can be viewed as elective deferrals and will enable a participant to qualify for employer matching contributions. It is not yet clear how these payments must be substantiated to the employer, but the rule applies to contributions made in plan years beginning after December 31, 2023. *FSCS Insight: For purposes of recruitment and retention of employees, this may be an attractive option for plan sponsors to consider*.

d. <u>Small Immediate Financial Incentives for Contributing to a Plan</u>

Prior to the Act, employers were precluded from providing financial incentives to participants (other than matching contributions) to motivate them to make elective deferrals to the plan.

The Act allows an employer to incentivize employees with financial incentives, such as low-dollar gift cards, to motivate them to make deferrals to their retirement plan. While there may be tax implications associated with such incentives, they may be offered after December 31, 2023. *FSCS Insight: A key purpose behind such an incentive is to increase plan participation and assist with overall retirement stability for plan participants.*

e. Governmental 457(b) Plan Deferrals - Elimination of "First Day of the Month" Requirement

Under current law, governmental 457(b) plan participants may only make changes to their elective deferral rate if the change is requested prior to the beginning of the month in which the deferral would be made. The Act allows such elections to be made at any time prior to the date that the compensation being deferred is available. This change applies to taxable years beginning after December 29, 2022. *FSCS Insight: This change will provide participants with greater flexibility to manage their own retirement strategies.*

f. Long-term Care Contracts Purchased with Retirement Plan Distributions

Under current law, distributions may only be taken from a qualified plan for certain reasons (e.g., termination of employment, attainment of age 59½, hardships).

The Act adds a new triggering event for distributions, allowing a retirement plan to permit distributions to a participant to pay for long-term care insurance contracts. The distribution amount is limited to the lowest of: (1) the amount paid by or assessed to the employee during the year for long-term care insurance; (2) 10% of the employee vested accrued benefit in the plan; or (3) $2,500. The $2,500 limit will be indexed over time beginning in 2025. Long-term care distributions are exempt from the additional 10% penalty on early distributions but will not become available until December 29, 2025. *FSCS Insight: This change will provide participants with greater flexibility to manage their own retirement and tax strategies.*

C. Administrative/Compliance Changes. Finally, the Act made certain changes to the overarching administrative and compliance requirements that generally apply to Plans. We outline a number of those changes below.

a. Employee Certifications for Hardship Withdrawals.

Prior to the Act, a plan participant requesting a hardship withdrawal from his or her Plan account was required to provide substantiation of the hardship event and the necessity of the amount requested.

The Act relaxes the substantiation requirements in certain situations and allows Plan Administrators to rely on a participant's self-certification that he or she experienced a hardship event, that the amount requested does not exceed the amount necessary to satisfy his or her need, and that he or she does not have reasonably available alternative financial means to satisfy the need. This change will apply to hardship withdrawals made after December 29, 2022. *FSCS Insight: This change will help employers* *reduce the administrative burden associated with hardship withdrawal requests.*

b. Timing of Amendments to Increase Plan Benefits.

Current law generally requires a Plan sponsor to adopt an amendment on or before the last day of the Plan Year in which the amendment will become effective.

The Act extends the plan amendment deadline in certain situations. It permits a Plan Sponsor to adopt an amendment that increases participant benefits on or before the deadline for filing the Sponsor's tax return for the year in which the amendment will become effective. This change becomes effective for Plan Years beginning after December 31, 2023. *FSCS Insight: This provision removes the technical obstacle that prevents a Plan Sponsor from making retroactive plan changes that benefit participants.*

c. Disclosures to Unenrolled Participants.

Under current law, Plan Administrators are required to provide Plan disclosures to all eligible participants, regardless of whether or not they are currently enrolled in the Plan.

The Act modifies the requirement to provide disclosures to unenrolled participants such as those eligible employees who choose not to enroll in the Plan. A Plan Administrator must provide only limited disclosures (e.g., annual notice of eligibility) to those unenrolled participants who previously received a Summary Plan Description and notice of eligibility. This change applies to Plan Year beginning after December 31, 2024. *FSCS Insight: This provision eases the administrative burden and expenses experienced by Plan Administrators when providing required disclosures.*

d. Requirement to Provide Paper Participant Statements.

Under current law, a Plan Administrator must provide a Participant with a statement of his or her account on a quarterly basis throughout the Plan Year. If certain requirements are satisfied, these statements may be provided to the Participant via electronic means.

The Act changes these rules to require that, unless a Participant elects otherwise, he or she must receive a paper copy of his or her statement at least once per year for defined contribution plans and at least once every three years for defined benefit plans. This change becomes effective for Plan Years beginning after December 31, 2025. *FSCS Insight: This change has the potential to increase certain administrative burdens and expenses by requiring Plan Administrators to generate and send paper statements.*

e. Timing of Amendment to Incorporate SECURE 2.0 Changes.

In general, the deadline for adoption of Plan amendments that incorporate SECURE 2.0 provisions is the last day of the Plan Year that begins on or after January 1, 2025 (i.e., December 31, 2025, for calendar year plans). *FSCS Insight: While it is always prudent to adopt an amendment on a prospective basis, under certain circumstances a retroactive plan amendment that conforms the Plan's terms to its* *administration is permitted.*

We will continue to monitor and keep you apprised of developments related to the SECURE Act 2.0. In the meantime, if you have any questions, please contact Mindi Johnson, Julie Hamlet, or Amanda Dernovshek.

- Mindi Johnson; (616)726-2252; mjohnson@fosterswift.com
- Julie Hamlet (616)796-2515; jhamlet@fosterswift.com
- Amanda Dernovshek (517) 371-8259; adernovshek@fosterswift.com