BY RYAN CURTIS & KRISTI HILL

SECURE Act 2.0
New and Enhanced Retirement Tools

The much anticipated SECURE Act 2.0 became law late in 2022, giving individuals and employers new and enhanced retirement savings tools. SECURE 2.0 was included in the $1.7 trillion omnibus spending bill signed into law in December 2022. It is follow-up legislation to the 2019 original SECURE Act (Setting Every Community Up for Retirement Enhancement Act) (SECURE 1.0) designed to increase employee access to tax-advantaged retirement plans. SECURE 2.0 expands options for individuals saving for and approaching retirement, introduces new options for retirement savings, and provides additional requirements and options for employers sponsoring qualified retirement plans.

Impact on Individuals Preparing for Retirement

Delays Required Minimum Distributions

For many years, individuals were generally required to begin taking Required Minimum Distributions ("RMDs") from their retirement accounts (including IRAs) by April 1 following the year they reached age 70½. SECURE 1.0 changed that to age 72, and SECURE 2.0 changes that age to 73, effective in 2023. The threshold moves to age 75 beginning in 2033.

These changes mean that individuals will have greater flexibility for when they actually take distributions from their retirement plans. For example, a person could start drawing from other retirement sources such as Social Security or a prior employ-

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er's retirement plan while still working, but they now will be able to wait even longer before being required to take distributions from their IRA or employer-sponsored retirement plan. Specifically, a person must start RMDs by April 1 following the year they reach age 73. For example, although SECURE 1.0 changed the RMD age to 72, individuals turning 72 in 2023 (born in 1951) can now delay one more year and will not need to take RMDs until April 1, 2025. Those born in 1958 or later will not need to take RMDs until April 1 following the year they reach age 75.

Importantly, if a person continues working for their employer beyond age 73, they still do not have to take distributions from that employer's plan until they actually retire. However, if a person owns five percent or more of the entity employing them, they will still need to start taking distributions when turning 73, even if they continue working. Similarly, because IRAs operate separate from a person's employer, a person still must take RMDs soon after reaching age 73 even if they continue working.

Employers sponsoring retirement plans will need to work with their consultants and plan recordkeepers to account for this change. This should involve communicating these requirements to affected plan participants and ensuring that RMDs occur as required. Ensuring proper distribution of RMDs is important because an individual who fails to timely take RMDs is subject to tax penalties.

Reduced Tax Penalty for Late RMDs

Congress did another favor for those approaching retirement age by reducing the excise tax required when late RMDs happen in SECURE 2.0. When a person fails to timely take RMDs, they are subject to an excise tax in addition to any ordinary income tax they owe on the distribution. Until SECURE 2.0, that excise tax had been a very draconian 50 percent—leaving the individual with just a fraction of what they hoped to receive. A person owed that 50 percent tax penalty unless they obtained a waiver by demonstrating good cause why the RMD did not occur. SECURE 2.0 reduces that excise tax to 25 percent. Furthermore, a person can request a reduction to a 10 percent penalty by (a) taking distribution of the missed amount and (b) filing a corrected tax return within two years of when the RMD should have happened.

Individuals approaching age 73 should take initiative to ensure they start taking timely RMDs. Those who miss RMDs should consult with their tax advisers about seeking possible reductions of any applicable excise tax. Even with the reduced excise tax, this can significantly affect a person's retirement situation. It warrants careful planning.

Increases and Other Changes to Catch-Up Contributions

The Internal Revenue Code limits the amount individuals can defer from their compensation to their 401(k) accounts. In 2023, that amount is $22,500. However, beginning in the year individuals reach age 50, they may make additional "catch-up contributions" to their qualified retirement

plan accounts. That amount will be $7,500 in 2023. To further assist older workers who may not have saved enough for retirement, beginning in 2024 SECURE 2.0 allows workers ages 60 to 63 to have an enhanced catch-up contribution. That contribution is the greater of $10,000 or one and a half times the regular catch-up amount. This applies not only to 401(k) plans, but also to 403(b) plans, governmental 457(b) plans, and SEP (simplified employee pension) plans.

When a person reaches age 64, they are no longer eligible for the enhanced catch-up amounts and are again limited to the regular catch-up amount. The IRS has had the authority to increase the regular catch-up limit and periodically does so. Under SECURE 2.0, the catch-up limit will be indexed for inflation beginning in 2025.

Catch-Up Contributions for Higher Incomes

When individuals are allowed to defer larger amounts to their 401(k) plans on a pre-tax basis, it naturally results in reduced tax revenue to the government. Presumably to account for this loss, SECURE 2.0 requires individuals with annual income in excess of $145,000 to have their catch-up contributions be treated as Roth (after-tax) deferrals. This income threshold will be based on the individual's prior calendar year's FICA wages from the employer. Going forward, the threshold amount will be indexed for inflation.

As a refresher for those not living the universe of qualified plan regulation, a Roth deferral requires that tax be paid on the amount deferred just as other compensation is taxed. However, no tax will be owed on that principal amount *or* the related earnings when that money is distributed to the individual at retirement. For traditional pre-tax deferrals, tax is only owed when the distribution occurs, including tax on all earnings accrued since the pre-tax deferrals were invested.

Notably, some employer plans do not allow for Roth contributions. Thus, unless such an employer amends its plan to allow for Roth contributions, its employees over the threshold limit would not be able to make any catch-up contributions. Affected employees interested in catch-up contributions should check plan terms. Such terms should be set forth in a plan's summary plan description. Employers also should review plan terms and consider amendments if the employer wants employees to be able to maximize their retirement savings.

New Options for Retirement Savings

Student Loan Payment Match Contributions

Effective in 2024, SECURE 2.0 will allow employers to make matching contributions to an employee's retirement account based on student loan payments the employee makes. Because more workers have large student loan debts coming out of college or other programs, some employees are forced to delay making meaningful 401(k) deferrals and consequently miss out on employer matching contributions. This provision is intended to enable employees to start building retirement savings even when they are paying off student loans. The sooner a person starts saving for retirement, the better off they will be as their retirement savings can be invested.

Some employers already have been contributing matches based on student loan payments with the informal approval from the IRS. SECURE 2.0 now gives clear authority for employers to implement this if they choose, but employers are not required to adopt this provision. This plan option could be an important tool for attracting and retaining workers in an environment of low unemployment and employers that face challenges maintaining a qualified workforce.

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Small Emergency Distributions

Starting in 2024, employees could take an emergency distribution once per year from their qualified retirement account balance for unforeseeable or immediate financial needs up to $1,000. Many employees and their families are living paycheck-to-paycheck. In those situations, any financial setback such as auto repairs or health problems could be significant. Accordingly, many individuals may not have sufficient discretionary income to set aside for retirement. Also, they might not defer much to a 401(k) plan out of concern they may have an emergency expense they simply cannot afford. Such distributions would be subject to ordinary income taxes but would not be subject to 10 percent early distribution penalties that normally apply for employees under age 59½.

This provision in SECURE 2.0 would enable employer plans to allow for these small distributions to cover such emergencies, but it does not require employers to offer this. Most likely, employers who adopt this provision would not be required to verify or document an employee's claimed emergency, but this provision could still be administratively burdensome on employers.

Other Incentives From Employers

Under SECURE 2.0, employers will be allowed to offer de minimis financial incentives such as small gift cards to help increase employee participation in the employer's retirement plan. Before SECURE 2.0, the only financial incentives employers could offer to increase participation were employer matching contributions. The small financial

incentives allowed under SECURE Act 2.0 will be exempt from prohibited transaction rules.

Tax-Free Rollovers from 529 Accounts to Roth IRAs

A Section 529 college savings account allows individuals to invest after-tax dollars in a tax-deferred account so that no tax is imposed on the account's earnings so long as the funds are used for qualified higher education expenses. Taxes and penalties may apply, however, if the funds are not used for such qualifying expenses. To alleviate individuals' concerns that their 529 accounts will be reduced by taxes and penalties if they don't ultimately need the funds for higher education purposes, beginning in 2024 SECURE 2.0 permits beneficiaries of such accounts to roll over distributions of up to $35,000 (over their lifetime) from their 529 account to a Roth IRA. To be eligible, the 529 account must have been open for at least 15 years. The annual rollover amount is subject to annual Roth IRA contribution limits (generally, $7,500 for 2023). These rollovers are not subject to any taxes or penalties. The rollover option serves to reward individuals who save for the rising costs of higher education by allowing them to retain their savings as retirement savings.

Employers Sponsoring Qualified Retirement Plans

Automatic Enrollment in New Plans

For plan years beginning in 2025, SECURE 2.0 requires employers with 401(k) or 403(b) plans initiated after 2022 to automatically enroll all eligible employees at a deferral rate of 3 percent to 10 percent of the employee's annual compensation, subject to an employee's election to opt out. This auto-enrollment must be done pursuant to an eligible automatic contribution arrangement, which allows for a permissive withdrawal feature if the participant elects not to participate in the first 90 days. In addition, the deferral rate must automatically increase by 1 percent each year until it reaches a maximum amount set by the employer of at least 10 percent (but not more than 15 percent). This is also subject to an employee's decision to change the amount deferred. This provision does not apply to governmental or church plans or to new or small businesses (business with 10 or fewer employees).

Plans with auto-enrollment features have been shown to significantly increase employee participation, and it is hoped that over time this provision will result in a much higher savings rate for American workers.

A new rollover option for 529 college-savings accounts rewards individuals who save for the rising costs of higher education by allowing them to retain their savings as retirement savings.

Inclusion of Certain "Long-Term Part-Time" Employees

SECURE 1.0 implemented a new provision to expand coverage for part-time workers. SECURE 1.0 required employers with 401(k) plans to allow "long-term part-time" (LTPT) employees to defer compensation to the plan if they complete three consecutive years with at least 500 hours of service, even if such employees would not otherwise be eligible under the terms of the plan. Employers are not required to provide any employer contributions to LTPT employees unless otherwise provided by plan terms, but employees would be allowed to defer compensation to their 401(k) accounts.

This provision is effective in 2024, but employers have had to start tracking hours for such employees to determine which employees are newly eligible to defer in 2024. There has been confusion among employers and consultants on how vesting service for LTPT employees is calculated under SECURE 1.0.

Effective in 2025, SECURE 2.0 reduces the LTPT eligibility requirement to two (rather than three) consecutive years with at least 500 hours of service in each year. It also extends these new LTPT requirements to ERISA 403(b) plans (typically sponsored by public schools and tax-exempt entities), which were not wrapped into the SECURE 1.0 provisions. It further clarifies that for 401(k) plans, pre-2021 service is disregarded for LTPT employees for vesting purposes for employer contributions. Overall, this provision further expands the availability of 401(k) deferrals to part-time employees. Employers may find it difficult to track these alternative eligibility requirements for such workers. Consequently, some employers have instead elected to expand their plan's overall eligibility to meet the LTPT requirements.

Incentives for "Starter" 401(k) or 403(b) Plans

SECURE 2.0 introduces a "starter" 401(k) or 403(b) plan for employers who do not already sponsor a retirement plan. The starter plan must automatically enroll employees at a deferral rate between 3 percent and 15 percent of pay. Employer contributions are not allowed. Deferrals are capped at the annual IRA contribution limits. SECURE 2.0 also expands the retirement plan startup tax credit for small employers. Employers with 50 or fewer employees are eligible for a tax credit of up to 100 percent of the cost to start and administer a plan, up to $5,000 per year, for three years.

Roth Employer Contributions

Effective in 2023, employers may for the first time offer employees the option of receiving employer matching or nonelective ("profit sharing") contributions as Roth contributions rather than as pre-tax contributions. These contributions must be 100 percent vested when made. This option may be appealing to some employees for tax diversification purposes or due to their individual tax situation. This new option may be administratively complicated, however, and guidance is needed regarding its implementation, including for withholding and income tax reporting purposes.

Expanded IRS Self-Correction Program for Qualified Plans and IRAs

The IRS correction program for qualified plans (the Employee Plans Compliance Resolution System or "EPCRS") is currently set forth in IRS Revenue Procedure 2021-30. It includes a self-correction program that has been gradually expanded over the last decade, and it is well established and frequently used by employers. SECURE 2.0 recognizes the complexity of retirement plan administration by further expanding the IRS self-correction program. Without self-correction, employers are required to identify and report errors and the corrections being taken in an application to the IRS through its Voluntary Correction Program ("VCP"). VCP applications require an application fee, can take several months to be reviewed and approved by the IRS, and often require an employer to engage legal counsel knowledgeable about such corrections to assist with the application.

SECURE 2.0 provides that any "eligible inadvertent failure" (which is broadly defined) may be self-corrected at any time regardless of its significance, unless the IRS identifies the failure before self-correction has begun, or the self-correction was not completed in a reasonable period after the failure was identified. Self-correction is explicitly permitted for eligible participant loan failures, and the Department of Labor is also required to acknowledge such self-corrections for its purposes. Within two years, the IRS must update EPCRS to add preapproved correction methods for eligible inadvertent failures. The IRS also must expand EPCRS to address inadvertent IRA errors. This expansion should assist employers in managing the complexity of plan administration and correct plan errors with reduced administrative burden and cost.

Conclusion

Both SECURE 2.0 and its prequel law SECURE 1.0 make significant changes to the American retirement plan landscape that affects individuals approaching retirement and those just starting their careers. These laws also affect employers, how they administer their plans, and different options they may implement. As with SECURE 1.0 and other legislation affecting qualified retirement plans, additional guidance regarding SECURE 2.0 will be forthcoming. Plans will generally need to be amended to comply with SECURE 2.0 by December 31, 2025, although many provisions are operationally effective prior to that date. Plan sponsors and employees should consult with their legal counsel, tax advisers and other service providers to determine how these and other aspects of SECURE 2.0 will affect them.