Congress Passes Legislation for Plan Sponsors and their Participants to encourage a "Secure" Retirement

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As 2022 drew to a close, Congress passed the SECURE 2.0 Act of 2022 ("SECURE 2.0") by attaching it as Division T to the much larger and broader Consolidated Appropriations Act, 2023. The provisions of SECURE 2.0 had strong bipartisan support and built upon the initial improvements of the "original" Setting Every Community Up for Retirement Enhancement Act ("SECURE Act") passed at the end of 2019. The main goals of SECURE 2.0 largely mirror those of the earlier SECURE Act, which were to: (1) encourage more businesses (particularly small businesses) to offer qualified retirement plans to their employees and (2) encourage more employees to not only enroll in those employer-provided retirement plans, but also increase the amounts they are able to contribute to their own retirement readiness.

GOAL #1: ENCOURAGE BUSINESSES TO OFFER QUALIFIED RETIREMENT PLANS

SECURE 2.0 encourages more small businesses to offer a qualified retirement plan by incentivizing them with certain credits that will reduce start-up costs while also making other legal changes to make plan administration easier.

CREDITS

Modification of credit for small employer qualified retirement plan startup costs

The original SECURE Act provided for a three-year tax credit for small employers that start new qualified plans. It was intended to offset startup costs but was limited to 50% of those administrative costs, up to an annual cap of $5,000. SECURE 2.0 increases the startup credit from 50% to 100% for small employers with up to 50 employees.

SECURE 2.0 goes on to add another credit to small employers who contribute to their employee's defined contribution ("DC") retirement plan account. The amount of this additional credit is a percentage of the amount contributed by the employer on behalf of employees, up to a per-employee cap of $1,000. This additional credit is limited to small employers with 50 or fewer employees and is phased out for employers with between 51 and 100 employees. The applicable percentage is 100% in the first and second years of the new plan's existence, 75% in the third year, 50% in the fourth, and finally 25% in the fifth year, at which time the credit ends.

These credits will be available for taxable years beginning after December 31, 2022.

Extension of credit for small employer plan startup costs for those who join an existing MEP/PEP

As written in the original SECURE Act, the three-year tax credit for small employer that start a qualified retirement plan (as described above) applies only for the first three years that a plan is in existence. This prevents eligibility for the credit by those small employers seeking to join an existing multiple employer plan ("MEP") or pooled employer plan ("PEP"). For example, if a small business joins a MEP or PEP that has already been in existence for three years or more, the startup credit is not available; if the MEP or PEP has been in existence for one or two years when a small employer joins, the small employer may claim the credit for only one or two years, respectively.

SECURE 2.0 fixes this problem by making it so that small employers joining a MEP or PEP are eligible for the credit for all three years, even if the MEP or PEP itself is already an existing plan.

These credits will thankfully be effective retroactively for taxable years beginning after December 31, 2019, so that those small employers who joined a MEP or PEP since the passage of the original SECURE Act are able to receive those credits.

New credit for small employers who make military spouses immediately plan eligible

SECURE 2.0 adds a new tax credit available to small employers who sponsor a DC retirement plan if they:

(1) make military spouses immediately eligible for plan participation within two months of hire,
(2) upon plan eligibility, make the military spouse eligible for any matching or nonelective contribution that they would have been eligible for otherwise at two years of service, and
(3) make the military spouse 100% immediately vested in all employer contributions.

The new tax credit equals the sum of (1) $200 per military spouse, and (2) 100% of all employer contributions, up to $300, made on behalf of the military spouse, for a maximum tax credit of $500. This credit also applies for three years *with respect to **each** military spouse*, ***but*** it does not apply to highly compensated employees. A small employer may rely on an employee’s certification that such employee’s spouse is a member of the uniformed services.

These credits will be available for taxable years beginning after December 31, 2022.

PLAN ADMINISTRATION

Allowing employers to replace SIMPLE retirement accounts with safe harbor 401(k) plans mid-year

Under existing law, an employer is unable to replace a SIMPLE IRA, which stands for a Savings Incentive Match Plan for Employees, with a new 401(k) plan mid-year. However, SECURE 2.0 adds language to the Internal Revenue Code (the “Code”) that allows an employer to replace a SIMPLE IRA plan with a SIMPLE 401(k) plan or other 401(k) plan that requires mandatory employer contributions during a plan year.

This law change has a slightly delayed effective date. It will not be available until taxable years beginning after December 31, 2023.

Expanding the Employee Plans Compliance Resolution System (“EPCRS”)

The IRS provides a means by which plans can correct operational errors. Revenue Procedure 2021-30 (“Rev. Proc. 2021-31”) is the current iteration of the EPCRS, which, depending on the particular operational error, requires the preparation and submission to the IRS of numerous forms and documentary evidence of said error and the steps taken to correct it, in order to ensure no enforcement action will be taken by the IRS if the error is discovered later.

SECURE 2.0 expands the existing EPCRS to

1. allow more types of errors to be corrected internally through self-correction,
2. apply to inadvertent IRA errors, and
3. exempt certain failures to make required minimum distributions from the otherwise applicable excise tax.

Particularly noteworthy, SECURE 2.0 changes to EPCRS will for the first time allow for self-correction of many plan loan errors. Historically, the administration of plan loans is a frequent area of error and can be burdensome to correct because even a single loan error required the submission to the IRS of a voluntary compliance procedure (“VCP”) application. VCPs are just one element of the IRS’s EPCRS under Rev. Proc. 2021-30.

This expansion of EPCRS also has a slightly delayed effective date. The IRS has two years from December [30], 2022, the date of enactment of SECURE 2.0, to issue any new or revised guidance on EPCRS procedures, including updates to Rev. Proc. 2021-30.

Creating new safe harbor for correcting elective deferral failures related to automatic enrollment

There is currently no remedy in the Code for correcting employee elective deferral failures. This means that any correction of errors related to the automatic enrollment of plan participants must be accomplished through the EPCRS procedures described above. The latest version of EPCRS does include a corrective safe harbor procedure for these errors. The safe harbor requires notice be given to the affected employee, correct deferrals to commence within certain specified time periods, and the employer to provide the employee with any matching contributions that would have been made if the failure had not occurred. However, this existing safe harbor corrective procedure expires December 31, 2023.

SECURE 2.0 adds a new provision to the Code that allows for a grace period to correct, without penalty, reasonable errors in administering these newly required automatic enrollment and automatic escalation features applicable to new plans. Errors must be corrected prior to 9½ months after the end of the plan year in which the mistakes were made.

Any errors tied to automatic enrollment and automatic escalation features that occur after December 31, 2023, will be eligible for correction under this new Code provision.

Increasing the dollar limit for mandatory distributions

Currently, the law permits employers to transfer former employees' retirement accounts from a workplace retirement plan into an IRA if their balances are between $1,000 and $5,000. The majority of employers do this to reduce the headcount of participants in their plan, which can reduce the occurrence of administrative errors and, particularly for small plans with 100 participants or less, can make annual reporting requirements significantly less burdensome.

SECURE 2.0 amends both the Employee Retirement Income Security Act of 1974 ("ERISA") and the Code by increasing the maximum dollar limit for mandatory distributions from $5,000 to $7,000. This will help employers force out more former employees from their plan if they choose to do so.

This increase will take effect for any distributions made after December 31, 2023.

Creating starter 401(k) plans for employers with no retirement plan

SECURE 2.0 adds a new provision to Code Section 401(k) that permits an employer that does not sponsor a retirement plan to offer a "starter 401(k) plan." These new starter 401(k) plans will generally require that all employees be default enrolled in the plan at a deferral rate of 3% to 15% of compensation. The limit on annual deferrals to these starter 401(k) plans would be the same as the lower IRA contribution limit, which for 2023 is $6,500 with an additional $1,000 in catch-up contributions beginning at age 50. Cost of living adjustments apply after 2024. There is no employer matching or nonelective contribution possible in these starter 401(k) plans.

Starter 401(k) plans will first be available beginning after December 31, 2023.

Eliminating notice requirements for unenrolled participants

Under current law, employees eligible to participate in a retirement plan are required to receive a broad array of notices that are intended to inform them of their various options and rights under the plan. However, these required notices, as applied to eligible employees who have not elected to participate in the plan ("unenrolled participants"), are generally unnecessary and just add administrative tasks that benefit no one.

SECURE 2.0 reduces those requirements so that employers will no longer have to provide certain intermittent notices to unenrolled participants who have not elected to participate in a qualified retirement plan. ***However***, to further encourage participation of unenrolled participants, the plan ***is*** required to send:

1. one annual reminder notice of the participant's eligibility to participate in the plan and any applicable election deadlines, and
2. any otherwise required document requested at any time by the participant.

This new rule applies only with respect to an unenrolled participant who received the summary plan description in connection with initial eligibility under the plan, and any other notices related to eligibility under the plan required to be furnished.

This new easing of the notice requirements applies quickly, starting with plan years beginning after December 31, 2022.

GOAL #2: ENCOURAGE EMPLOYEES TO PARTICIPATE IN, AND CONTRIBUTE MORE TO, QUALIFIED RETIREMENT PLANS

SECURE 2.0 encourages more employees to enroll in employer-provided qualified retirement plans by offering a few different financial incentives, making it easier to access limited amounts of retirement savings while still working, and at the same time increasing both the amounts that participants may save and the time during which participants may hold on to their savings.

Creating a Saver's Matching Credit

There is an existing ***nonrefundable credit*** for certain individuals who make contributions to individual retirement accounts ("IRAs") and employer-provided qualified retirement plans (such as 401(k) plans). Unfortunately, the credit is confusing because the amount is an adjustable percentage based on an individual's income and filing status; more significantly, because of the nonrefundable nature of the credit, it cannot be larger than an individual's overall tax liability. This means that the credit can be reduced, or even go away completely, if an individual's tax bill is low.

SECURE 2.0 replaces the current nonrefundable credit paid directly as part of a tax refund into a federal matching contribution that ***must*** be deposited into an individual's IRA or retirement plan, as elected by that taxpayer. The new Savers Match contribution is intended to help ensure that the tax credit will be directly used to help build up an individual's retirement savings.

This new and improved "Savers Match" credit will be a simple 50% of IRA or retirement plan contributions up to $2,000 per individual. The percentage will no longer change depending on income or filing status. The match will phase 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 those married filing separately, and $30,750 to $53,250 for head of household filers. Those amounts will be adjusted to reflect increases in the cost of living.

Separately from the new Savers Match credit itself, SECURE 2.0 also contains a separate provision that directs the Treasury Department to increase public awareness of the new and improved credit by promoting its use by low and moderate income taxpayers. The promotion will make clear that the Saver's Match cannot be withdrawn without incurring penalties, including repayment to the Treasury Department in some cases where the Saver's Match is withdrawn before retirement.

Unfortunately, this new and improved Savers Match credit has a delayed effective date. It will not be available until taxable years beginning after December 31, 2026.

Allowing small financial incentives for contributing to a qualified retirement plan

Employer matching contributions are currently the only real "incentive" for encouraging employees to contribute to a qualified retirement plan. However, this incentive acts over the long-term and unfortunately, immediate financial incentives (like gift cards in small amounts) are currently legally prohibited even though studies suggest these small incentives may be especially successful at convincing more people to join their employers' retirement plans.

SECURE 2.0 removes this prohibition against immediate financial incentives, enabling employers to offer de minimis financial amounts, such as low-dollar gift cards, to boost employee participation in workplace retirement plans. Note that such de minimus financial incentives may not be paid for with plan assets by those employers who choose to offer such incentives.

Employers may begin to use these newly available financial incentives immediately.

Allowing more penalty free in-service withdrawals

The Code currently imposes a 10% penalty on withdrawals from DC qualified retirement plans before a participant's normal retirement age, including hardship distributions, unless an exception applies. This tax penalty has always had a negative impact on plan participation, as many individuals delay deferring into retirement plans until they have adequate cash reserves on hand to pay for emergency expenses. SECURE 2.0 amends the Code to provide for various potential exceptions to the 10% penalty for certain distributions. Among those new potential opportunities for penalty free in-service withdrawals are plan distributions for the following reasons:

Emergency expenses –These are expenses that are unforeseeable or immediate financial needs relating to personal or family emergencies. Only one distribution of up to $1,000 is permissible per year, and the participant has the option to repay the distribution within three years. No further emergency distributions will be permissible during the three-year repayment period unless repayment occurs.

These new emergency withdrawal provisions will be permitted to be added to qualified retirement plans after December 31, 2023.

Domestic abuse – A plan participant who self-certifies that they experienced domestic abuse may withdraw a small amount of money (the lesser of $10,000, indexed for inflation, or 50% of the participant's account). Like the emergency withdrawals described immediately above, a participant will also be able to repay this withdrawn money back to the retirement plan over three years.

This new optional in-service withdrawal provision may be added to qualified retirement plans after December 31, 2023.

Purchasing long-term care contracts ("LTC") – A plan participant may take an in-service distribution of up to $2,500 per year for the payment of premiums for certain specified LTC insurance contracts. It is important to note that to qualify for such an early distribution that is exempt from the additional tax, the individual must purchase certain policies that cover "qualified long-term care services" (as defined by the Code) or otherwise cover individuals who become "chronically ill" (as defined by the Code).

This new in-service withdrawal provision has a delayed effective date. Provisions allowing for in-service withdrawals for purposes of paying for such LTC premiums may be added to qualified retirement plans three years after the enactment of SECURE 2.0, December 29, 2025.

Qualified federally declared disasters – A plan participant who has been impacted by a federally declared disaster may take up to $22,000 from their qualified DC retirement plans. The amount of this type of distribution will be spread out as gross income over three years. Distributions can be repaid to any tax preferred retirement account within the same three-year period. In addition, amounts distributed prior to the federally declared disaster to purchase a home can be recontributed. Also of significance, an employer will also be permitted to provide individuals impacted by a federally declared disaster with a larger amount to be borrowed from the plan as a loan as well as additional time for repayment of plan loans.

Plan sponsors may choose to permit these in-service withdrawals and more generous loan provisions in connection with any qualified federally declared disaster occurring on or after January 26, 2021.

Allowing separate emergency savings accounts linked to qualified DC retirement plans

SECURE 2.0 added multiple new provisions to ERISA to provide employers the option to offer their non-highly compensated employees emergency savings accounts that are directly linked to their qualified retirement plan. Employers may even automatically opt employees into these accounts at no more than 3% of their salary. The portion of the separate emergency savings account attributable to the employee's contribution is capped at $2,500 (or lower as set by the employer). Once the cap is reached additional contributions may be directed to the employee's Roth subaccount (if they have one) in their DC retirement plan, or stopped until the balance attributable to the employee's contributions falls below the cap.

Contributions to the emergency savings account will be made on an after-tax basis and contributions made directly to the employee's retirement plan after reaching the cap will be made as elective Roth contributions. The contributions into the emergency savings account will also be treated as elective deferrals for purposes of retirement plan matching contributions -

with an annual matching cap attributable to the emergency savings contributions set at the maximum account balance – i.e., $2,500 or lower as set by the plan sponsor.

Plan participants may take up to four withdrawals from the emergency savings account each plan year without being subject to any fees or charges solely on the basis of such withdrawals. When plan participants separate from service, they may take their emergency savings accounts as cash or roll it into the Roth subaccount of their DC retirement plan or Roth IRA.

Plan sponsors may link these new, separate emergency savings accounts to their qualified DC plans in any plan year beginning after December 31, 2023.

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

Although there are currently no provisions in ERISA or the Code that allow an employer to make matching contributions based on a participant's repayment of student loan debt, at least one employer has received a private letter ruling from the IRS that authorizes this practice.

SECURE 2.0 makes changes to the Code to expressly permit an employer to make matching contributions under a qualified 401(k) plan 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. For purposes of the nondiscrimination test applicable to elective contributions in qualified plans, SECURE 2.0 expressly permits a plan to test separately the employees who receive matching contributions on student loan repayments to prevent negative impacts to plan testing that may otherwise result for those plan sponsors who opt to implement this provision.

Matching contributions attributable to qualified student loan payments may be made to plans that choose to adopt such matching provisions for plan years beginning after December 31, 2023.

Expanding automatic enrollment and automatic escalation

Although it is already permitted in certain arrangements, automatic enrollment and automatic escalation features are not required for qualified 401(k) plans, despite a significant amount of data linking automatic enrollment and automatic escalation features to higher plan participation rates and higher contribution amounts.

Due to the strength of the link between automatic enrollment and auto escalation with better retirement outcomes, SECURE 2.0 adds provisions to the Code that require qualified 401(k) plans to automatically enroll participants in the respective plans upon becoming eligible. Employees will still be able to opt out of such participation. The automatic enrollment amount will initially be at least 3%, but not more than 10%. Each year thereafter the amount deferred by such auto-enrolled participant will be automatically increased by 1% until it reaches at least 10%, but not more than 15%.

This new automatic enrollment requirement will be effective ***only for new plans*** beginning on or after December 31, 2024. All current 401(k) plans already in existence at that time will be grandfathered. Small businesses with 10 or fewer employees and new businesses (i.e., those that have been in business for less than 3 years) will also be exempt from this new automatic enrollment and automatic escalation requirement.

Improving qualified plan coverage for part-time workers

The original SECURE Act required employers to allow long-term, part-time employees to make employee elective deferrals to 401(k) plans, although an exception was allowed for collectively bargained plans. Employers were also not required to provide any matching or employer nonelective contributions to such long-term, part time employees, which were defined as those with three consecutive years of completing at least 500 hours of service.

SECURE 2.0 reduces the three-year, 500-hour service requirement so that now long-term, part-time employees need only two consecutive years of completing at least 500 hours of service to be eligible to make employee elective deferrals to 401(k) plans. Employers are still free to disregard these long-term, part time employees for purposes of providing matching or nonelective contributions.

The reduced two-year service requirement will be effective for plan years beginning after December 31, 2024. SECURE 2.0 also clarifies that for vesting purposes of any matching or other nonelective contributions, pre-2021 service may be disregarded.

Increasing age for RMDs

The original SECURE Act increased the age at which participants are generally required to begin taking distributions from their retirement plans from age 70½ to age 72.

SECURE 2.0 gradually increases the age at which RMDs must begin even further over the next decade. The applicable RMD age will be 73 for someone who attains age 72 after December 31, 2022, and age 73 before January 1, 2033. For someone who attains age 74 after December 31, 2032, the applicable age is 75.

Increasing the catch-up limit at ages 60 - 63

The limit on catch-up contributions for 2023 will be $7,500. SECURE 2.0 significantly increases this limit for those individuals who have reached age 60, 61, 62, and 63 by the end of the taxable year. The new maximum contribution limit for individuals in this 4-year age window will be 50% more than the regular catch-up contribution maximum effective in 2025 and will be indexed for inflation thereafter. For other changes related to catch-up contributions from SECURE 2.0, please read about the "Rothification of catch-up contributions" in the next section of this white paper.

The new increased catch-up contribution limits will be permitted in taxable years beginning after December 31, 2024.

Expanding and changing of Roth-related provisions

SECURE 2.0 contains numerous different provisions that change how qualified DC retirement plans treat Roth contributions and Roth subaccounts within qualified retirement plans. Roth contributions are deposited into qualified DC retirement plans on an after-tax basis and the earnings on those Roth contributions will not be subject to tax upon distribution in retirement so long as certain requirements are met. Roth contributions are popular because they provide individuals an additional source of tax-free funds from which to draw at any time in retirement.

Rothification of catch-up contributions - SECURE 2.0 will for the first time require all catch-up contributions made by employees who are at least 50 or older be subject to Roth tax treatment. However, an exception for that required Roth treatment will be made for those employees with annual compensation in the previous plan year of $145,000 or less (as indexed for inflation). The required Roth tax treatment will apply to catch-up contributions beginning in taxable years beginning after December 31, 2023.

Optional rothification of employer matching or nonelective contributions – SECURE 2.0 will for the first time permit qualified DC retirement plans to provide participants with the option of receiving employer matching or nonelective contributions on a Roth basis. This new Roth treatment will be permitted immediately in those plans that choose to implement these new provisions.

Removal of required minimum distribution ("RMDs") rules on Roth sub-accounts – Although RMDs are not required to begin before the death of a Roth IRA owner, pre-death RMDs are currently required for participants who hold amounts in a Roth subaccount within a qualified DC retirement plan. This makes the RMD rules apply more favorable to Roth IRAs versus Roth amounts in qualified plans.

SECURE 2.0 makes changes to the Code so that Roth subaccounts in qualified DC retirement plans will be treated just as a Roth IRA. In other words, it eliminates the pre-death distribution requirement for Roth subaccounts within qualified plans. This will effectively shield Roth amounts in qualified DC retirement plans from application of the RMD rules, which will increase the amount of time those Roth amounts within the retirement plan may grow tax free.

This change to the RMD rules applicable to Roth subaccounts within qualified plans will begin in taxable years beginning after December 31, 2023. However, note that this change does not apply to distributions that are required with respect to years beginning before January 1, 2024, but are permitted to be paid on or after such date.

IN SUMMARY

The legal changes and additions described above are the most significant for plan sponsors of qualified retirement plans, and those contemplating sponsoring such a plan, should be aware of. But this white paper summarizes just a portion of the very large SECURE 2.0. For a more comprehensive summary of SECURE 2.0 and to find related educational materials, please access the Nationwide Retirement Solutions SECURE 2.0 hub.

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