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Locke Lord QuickStudy: Secure 2.0: Top Changes Affecting ?Retirement Plans

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The Securing a Strong Retirement Act of 2022 ("SECURE 2.0") was signed into law by President Joseph Biden on December 29, 2022 as part of the Consolidated Appropriations Act of 2023. SECURE 2.0 expands upon the retirement plan provisions contained in the Setting Every Community Up for Retirement Enhancement Act of 2019 ("SECURE Act").

This QuickStudy highlights the important changes in SECURE 2.0 affecting retirement plans and plan sponsors.

1. Changes to Required Minimum Distributions

?•? Increase in Age for Required Beginning Date

The SECURE Act increased the age that retirement plan participants are required to begin taking distributions from their retirement plans from age 70-½ to age 72.

SECURE 2.0 increases that age to 73 beginning January 1, 2023 (for individuals who attain age 72 after December 31, 2022 and age 73 before January 1, 2033) and increases the age further to 75 beginning January 1, 2033 (for individuals who attain age 74 after December 31, 2032). Participants who attained age 72 before 2023 are subject to the prior rule requiring distributions to begin at age 72 (or 70-½, as applicable).

?•? Lower Tax Penalties for Failure to take RMD

Under current law, the additional taxes for failing to take required minimum distributions is 50% of the amount by which the required minimum distribution amount exceeds the actual amount distributed.

SECURE 2.0 lowers this rate to 25%. The change is effective immediately.

?•? No RMDs for Roth Portion of Retirement Plans

Under current law, required minimum distributions are not required to begin prior to death of the owner of a Roth IRA. However, pre-death distributions are required in the case of a participant who holds assets in a Roth designed account in a retirement plan. Typically, participants would roll over designated Roth account balances to a Roth IRA to avoid this disparate result.

SECURE 2.0 eliminates the pre-death distribution requirement for Roth accounts in retirement plans, effective for tax years beginning January 1, 2024. This change does not apply to required minimum distributions required for tax years before the effective date but paid on or after such date.

2. Changes to Catch-Up Contributions

?•? Higher Catch-Up Limit

Participants age 50 or older may make catch-up contributions to retirement plans in excess of otherwise applicable limits (the limit for 2023 is $7,500), if the retirement plan otherwise provides for such catch-up contributions. For plan years beginning in 2025, SECURE 2.0 increases the catch-up limit for participants who are age 60-63 in the applicable year to the greater of (i) $10,000 (indexed) or (ii) 150% of the 2024 "regular" catch-up contribution amount.

?•? Roth Catch-Up Contributions for Certain Participants

Under current law, catch-up contributions can be made on a pre-tax or Roth basis for participants who are age 50 or older in the calendar year.

Effective for plan years beginning after December 31, 2023, catch-up contributions for participants with compensation in excess of $145,000 (indexed) must be made as Roth contributions.

Retirement plans that do not offer Roth contributions will be required to amend the plan to offer such contributions.

3. New Employer Match for Student Loan Payments

Recognizing that employees with student loan debt may not be able to save for retirement and are missing out on available matching contributions, SECURE 2.0 allows employers to make matching contributions to a 401(k) and 403(b) plan by treating an employee's "qualified student loan payments" (up to certain limits) as elective deferrals.

This provision is effective for plan years beginning after December 31, 2023.

4. Employer Contributions Designated as Roth Contributions

Under pre-SECURE 2.0 law, plan sponsors could not provide employer matching contributions or non-elective contributions to 401(k) or 403(b) plans on a Roth basis. Such contributions had to be made on a pre-tax basis only.

SECURE 2.0 permits 401(k) and 403(b) plans to allow matching and non-elective contributions to be made as Roth contributions. Employer contributions designated as Roth contributions are not excludable from the employee’s income and must be immediately 100% vested.

This provision is effective immediately.

5. Incentives for Plan Participation

Under pre-SECURE 2.0 law, employers could not provide immediate financial incentives to encourage employees to participate in a retirement plan (other than matching contributions).

SECURE 2.0 allows employers to provide “de minimis” financial rewards, not paid with plan assets, such as low-dollar gift cards, to boost employee participation in 401(k) and 403(b) plans.

This provision is effective immediately.

6. Mandatory Distributions

Under current law, plans may transfer former participants’ retirement accounts from the retirement plan to an IRA if their account balances are between $1,000 and $5,000.

SECURE 2.0 increases the limit from $5,000 to $7,000, effective for distributions made after December 31, 2023.

7. Hardship Distributions and Penalty-Free Withdrawals

?•? Employee Self-Certification

Plans may now rely upon a participant’s self-certification that the participant had an event that constitutes a hardship in accordance with the terms of the plan, the participant has no alternative means to satisfy such financial need and the distribution is not in excess of the amount needed for purposes of taking a hardship withdrawal.

This provision is effective immediately.

?•? Penalty-Free Withdrawals

Domestic Abuse. Retirement plans may permit participants that self-certify that they experienced domestic abuse to withdraw the lesser of $10,000 (indexed) or 50% of the participant’s vested account. Withdrawals are not subject to the 10% additional tax on early distributions and the participant may repay the withdrawal to the retirement plan over a period of three years.

Emergency Expenses. Retirement plans may permit participants that self-certify that the distribution is for unforeseeable or immediate financial needs relating to personal or family emergency expenses to take a withdrawal up to $1,000 in a calendar year. Withdrawals are not subject to the 10% early distribution additional tax, and may be repaid over a three-year period. No additional emergency withdrawals may be made in the three-year repayment period unless the original withdrawal is repaid.

Terminally-Ill Participants. Distributions from retirement plans to terminally-ill participants will not be subject to the 10% additional tax on early distributions.

These provisions are effective immediately.

8. Automatic Enrollment

New 401(k) and 403(b) plans adopted after December 31, 2024 must provide an automatic enrollment feature. The initial automatic enrollment contribution amount must be at least 3% and not more than 10% of the participant's compensation. Each year thereafter, the contribution amount automatically escalates by 1% until it reaches at least 10% but not more than 15%. Employees may opt out of participation. All current 401(k) and 403(b) plans are grandfathered. There are certain exceptions for small businesses, new businesses and governmental plans.

9. Part-Time Workers

The SECURE Act requires employers to allow long-term part-time workers to participate in the employer's 401(k) plan. Under current law, employers can limit eligibility for part-time workers to the later of (i) age 21 or completes either 12-months of service in which the employee worked at least 1,000 hours or (ii) three consecutive years of service with 500 or more hours in each year. This coverage rule did not apply to 403(b) plans.

SECURE 2.0 retains the current provision but reduces the three-year requirement to two consecutive years of service with 500 or more hours in each year. SECURE 2.0 also extends the long-term part-time worker coverage rules to 403(b) plans.

This change is effective for plan years beginning after December 31, 2024, and excludes service before January 1, 2021. It also applies to 403(b) plans.

10. 403(b) Changes

?•? Hardship Withdrawals

Under current law, the hardship distribution rules are different between 401(k) plans and 403(b) plans. For example, 401(k) plans may allow both employee and employer contributions (plus earnings) to be available for a hardship distribution whereas 403(b) plans may only allow employee contributions (without earnings) are available for hardship distributions.

Effective for plan years beginning after December 31, 2023, SECURE 2.0 conforms the hardship distributions rules for 403(b) plans to the 401(k) rules.

?•? Collective Investment Trusts

Under current law, 403(b) plan investments are limited to annuity contracts and publicly traded mutual funds. Such plans could not invest in collective investment trusts which are often used by 401(a) plans to expand investment options for plan participants at a lower overall cost.

SECURE 2.0 allows 403(b) custodial accounts to invest in collective investment trust. NOTE: Although this provision is effective immediately, SECURE 2.0 did not make corresponding changes to applicable securities law, which means that 403(b) plans will not be able to invest in collective investment trusts until such changes occur.

?•? MEP and PEP Arrangements

Under current law, 401(k) plans can participate in multiple employer plans and pooled employer plans but 403(b) plans cannot. Starting in 2023, SECURE 2.0 allows 403(b) plans to participate in multiple employer plans and pooled employer plans.

Plan Amendment Deadline

Plan sponsors have until the last day of the first plan year beginning on or after January 1, 2025 to amend plans for SECURE 2.0 as long as the plan operates in accordance with such amendments as of the effective date that applies under SECURE 2.0 or the date the plan was amended in operation, as applicable.

SECURE 2.0 also extends the amendment deadlines for other recent legislation – SECURE 1.0, the CARES Act and Taxpayer Certainty and Disaster Relief Act of 2020 – to be the same as the SECURE 2.0 deadlines.

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