Key Provisions of SECURE 2.0

In late December while most practitioners and their clients were busy with other things, Congress was passing a giant omnibus budget bill. Buried within it was the Setting Every Community Up for Retirement Enhancement 2.0 Act of 2022 (SECURE 2.0), which contains many retirement (and some other) changes that practitioners and their clients need to be aware of. It provides new incentives for employers to offer retirement plans to their employees and for the employees to participate and improve their retirement security. SECURE 2.0 helps employees and their beneficiaries, owner-employees, small businesses, and retirees, and eases costs, administrative burdens, and penalties for inadvertent mistakes. It will also require most plans to be amended to comply with some of its provisions. The 2023 omnibus bill containing the following key provisions was signed into law by the President on December 29, 2022.

Provisions Benefiting Individuals

Tax-free rollovers from 529 accounts to Roth IRAs. After 2023, the Act permits beneficiaries of 529 college savings accounts to make up to $35,000 of direct trustee-to-trustee rollovers from a 529 account to their Roth IRA without tax or penalty. The 529 account must have been open for more than 15 years, and the rollover is limited to the amount contributed to the 529 account (and its earnings) more than five years earlier. Rollovers are subject to the Roth IRA annual contribution limits but are not limited based on the taxpayer's AGI.

Age increased for required distributions. Under the Act, the age used to determine required distribution beginning dates for IRA owners, retired employer plan members, and active-employee 5%-owners increases, in two stages, from the current age of 72 to age 73 for those who turn age 72 after 2022, and to age 75 for those who attain age 74 in 2032.

Bigger catch-up contributions permitted. Starting in 2025, the Act increases the current elective deferral catch-up contribution limit for older employees from $7,500 for 2023 ($3,500 for SIMPLE plans) to the greater of $10,000 ($5,000 for SIMPLE plans), or 50% more than the regular catch-up amount in 2024 (2025 for SIMPLE plans) for individuals who attain ages 60-63. The dollar amounts are inflation-indexed after 2025.

More penalty-free withdrawals permitted. The Act adds an exception after 2023 to the 10% pre-age-59½ penalty tax for one distribution per year of up to $1,000 used for emergency expenses to meet unforeseeable or immediate financial needs relating to personal or family emergencies. The taxpayer has the option to repay the distribution within three years. No other emergency distributions are permissible during the three-year period unless repayment occurs.
Similarly, plans may permit participants that self-certify having experienced domestic abuse to withdraw the lesser of $10,000, indexed for inflation, or 50% of their account

free from the 10% tax on early distributions. The participant has the opportunity to repay the withdrawn money from the retirement plan over three years and get a refund of income taxes on money that is repaid. Also, the additional 10% early distribution tax no longer applies to distributions to terminally ill individuals.

Beginning December 29, 2025, retirement plans may make penalty-free distributions of up to $2,500 per year for payment of premiums for high quality coverage under certain long term care insurance contracts.

Also, retroactive for disasters after January 25, 2021, penalty free distributions of up to $22,000 may be made from employer retirement plans or IRAs for affected individuals. Regular tax on the distributions is taken into account as gross income over three years. Distributions can be repaid to a tax preferred retirement account. Additionally, amounts distributed prior to the disaster to purchase a home can be recontributed, and an employer may provide for a larger amount to be borrowed from a plan by affected individuals and for additional time for repayment of plan loans owed by affected individuals.

The Act also contains an emergency savings provision that allows employers to offer non-highly compensated employees emergency savings accounts linked to individual account plans that automatically opt employees into these accounts at no more than 3% of their salary, capped at a maximum of $2,500. Employees can withdraw up to $1,000 once per year for personal or family emergencies without certain tax consequences.

Reduced penalty tax on failure to take RMDs. For tax years beginning after December 29, 2022, the Act reduces the penalty for failure to take required minimum distributions from qualified retirement plans, including IRAs, or deferred compensation plans under Code Sec. 457(b) from the current 50% to 25% of the amount by which the distribution falls short of the required amount. It reduces the penalty to 10% if the failure to take the RMD is corrected in a timely manner.

Favorable surviving spouse election. For plan years after 2023, the surviving sole spousal designated beneficiary of an employee who dies before RMDs have begun under an employer qualified retirement plan may elect to be treated as if the surviving spouse were the employee for purposes of the required minimum distribution rules. If the election is made distributions need not begin until the employee would have had to start them.

This provision allows a designated spousal beneficiary to receive a similar distribution period for lifetime distributions under an employer plan as is permitted if the surviving spouse rolled the amount into an IRA.

IRS will prescribe the time and manner of the election, which once made may not be revoked without IRS' consent.

Employer match for student loan payments. To assist employees who may not be able to save for retirement because they are overwhelmed with student debt and are missing out on available matching contributions for retirement plans, SECURE allows them to receive matching contributions by reason of their student loan repayments. For plan years after 2023, it allows employers to make matching contributions under a 401(k) plan, 403(b) plan, or SIMPLE IRA for "qualified student loan payments."

More qualify for ABLE programs. States may establish tax-exempt ABLE programs to assist persons with disabilities. Under current law, an individual must become disabled or blind before age 26 to be eligible to establish an ABLE account. The Act raises the age threshold from 26 to 46. The change is effective for tax years beginning after 2025.

Tax-exempt disability retirement payouts for first responders*.* The Act allows law enforcement officers, fire fighters, paramedics, and emergency medical technicians to exclude from gross income certain service-related disability pension or annuity payments (from a 401(a), 403(a), governmental 457(b), or 403(b) plan) after they reach retirement age. The exclusion applies to amounts received for post-2026 tax years.

Telehealth exemption for HDHPs*.* To facilitate the use of telehealth during the COVID pandemic, the CARES Act provided that coverage for telehealth and other remote care services would be disregarded coverage, which could be provided before a High Deductible Health Plan minimum deductible was satisfied without causing a loss of Health Savings Account eligibility for plan years beginning before 2022. The Act amends the IRC to provide that the exception for telehealth and other remote care services applies to plan years beginning after 2022 and before 2025.

Return of excess contributions*.* The Act specifies that earnings attributable to excess IRA contributions that are returned by the taxpayer's tax return due date (including extensions) are exempt from the 10% early withdrawal tax. The taxpayer must not claim a deduction for the distributed excess contribution. This applies to any determination of, or affecting, liability for taxes, interest, or penalties made on or after December 29, 2022.

Time limit on excess contribution excise tax. The Act provides that the statute of limitations for the assessment of excise taxes on excess contributions to tax-favored accounts and accumulations on qualified retirement plans begins to run on the filing of the taxpayer's income tax return for the year of the violation and runs for three years (six years in the case of excess contributions). The starting point no longer depends on the plan's filing an excise tax return.

Small Business Provisions

Bigger tax credit for start-up retirement plans*.* The SECURE Act improves the small employer pension plan start-up cost credit in three ways for tax years starting after 2022.

First, it makes the credit equal to the full amount of creditable plan start-up costs for employers with 50 or fewer employees (up to an annual cap). Previously only 50% of costs were allowed (which still applies to employers with 51 to 100 employees).

The Act also retroactively fixed a technical glitch that prevented employers who joined multi-employer plans in existence for more than three years from claiming the start-up

cost credit. Employers that joined a pre-existing multi-employer plan in 2000 or 2001 should contact us about filing amended returns claiming the credit.
Perhaps the biggest change is that certain employer contributions for a plan's first five years now may qualify for the credit. The credit is increased by a percentage of employer contributions, up to a per-employee cap of $1,000: It is 100% in the plan's first and second tax years, 75% in the third year, 50% in the fourth, and 25% in the fifth. For employers with between 51 and 100 employees, the contribution portion of the credit is reduced by 2% times the number of employees above 50.
In addition, no employer contribution credit is allowed for contributions for employees who make more than $100,000 (adjusted for inflation after 2023). The credit for employer contributions also is not available for elective deferrals or contributions to a defined benefit pension plan.

New credit for military spouses. The Act adds a new tax credit for employers with no more than 100 employees earning at least $5,000 for the preceding year for each military spouse who starts participating in an eligible employer defined contribution plan. Highly compensated employees are excluded from consideration. The annual credit amount for the year the spouse begins participating in the plan and each of the next two tax years is (1) $200 for each plan-participating military spouse, plus (2) up to $300 of related employer plan contributions. This new credit is available for tax years beginning after December 29, 2022.

Retroactive first-year deferrals for sole proprietors. To correct the situation where a sole proprietor can't make an elective deferral for the first year to a plan created after the close of the year, the Act provides, for plan years beginning after 2022 for a sole proprietor who is the only employee of an unincorporated trade or business, that any elective deferral made by the proprietor's original tax return due date ending after or with the end of the plan's first plan year, will be treated as made before the end of that first plan year.

Key Retirement Plan Provisions

Automatic salary deferral enrollment*.* For plan years beginning after 2024, the Act provides that a plan that permits salary deferrals generally will not be treated as a qualified cash or deferred arrangement or annuity contract unless it includes an automatic contribution arrangement (EACA) that satisfies these requirements:

1. it must allow permissible withdrawals within 90 days after the first elective contribution.

2. automatic contributions must be 3% to 10% during a participant's first participation year, unless the participant elects out, automatically increasing by

one percentage point each year to between 10% and 15% (but no more than 10% for plan years ending before 2025 for any non-"safe harbor" plan; and

3. if the participant makes no investment election, automatically contributed amounts must be invested in accordance with DOL default investment rules.

Exceptions: Automatic enrollment is not required for SIMPLE 401(k) plans, plans established before December 29, 2022, governmental or church plans, plans maintained by an employer in existence for less than three years or with fewer than 11 employees.

New "starter" 401(k) plans. The Act establishes two new kinds of retirement plan designs for plan years beginning after 2023, which smaller employers may be inclined to offer to employees due to their eased costs and administrative burdens:

1. a new type of section 401(k) plan called a starter 401(k) deferral-only arrangement, which is a cash or deferred arrangement maintained by an eligible employer that automatically satisfies the actual deferral percentage (ADP) nondiscrimination test. An employer can generally offer this type of plan only if it maintains no other plan in that year. All employees who meet the plan's age and service requirements must be eligible to participate.

2. The contribution percentage must be from 3% to 15%, applied uniformly. Employees may elect out or choose to contribute at a different level. No matching or nonelective contributions are permitted. Employee elective contributions for a calendar year may not exceed $6,000, adjusted for inflation, but catch-up contributions of up to $1,000, inflation indexed, are permitted for employees aged 50 or over. A new type of 403(b) plan called a safe harbor deferral-only plan, for which requirements similar to those described for starter 401(k) deferral-only arrangements apply.

Improved coverage for part-timers. The Act modifies the rules that apply to long-term part-time employees under a 401(k) or 403(b) plan subject to ERISA to reduce the service requirement for those employees from three years to two consecutive years, for employees who have worked for the employer at least 500 hours per year and have met the minimum age 21 requirement by the end of the two-year period. This change is effective for plan years beginning after 2024.

More plan self-correction permitted. The Act expands the use of self-correction under the IRS Employee Plans Compliance Resolution System (EPCRS) in a number of ways. It generally allows qualified plans under Code Sec. 401 , Code Sec. 403 , as well as SEPs and SIMPLE IRAs under Code Sec. 408 to self-correct certain inadvertent failures (defined expansively, but not including egregious or abusive violations), including participant-loan-related errors, without advance permission, unless the error is identified by IRS before any corrective actions is taken, or the self-correction is not completed

within a reasonable time after the failure is identified.
The Act also directs IRS to allow custodians to use EPCRS to address various IRA failures, including failures to make required minimum distributions and attempted rollovers by nonspouse beneficiaries from inherited IRAs. These provisions are effective as of December 29, 2022, and EPCRS must be revised for these changes within two years.

Eased notice requirements for unenrolled participants. For plan years after 2022, the Act exempts defined contribution plans from intermittent notification requirements for participants who elect not to participate, and who have already received a summary plan description and any other notices related to initial eligibility. However, unenrolled participants must still receive: an annual reminder notice of their eligibility to participate with any applicable deadlines; and certain other documents they request.

Extended plan amendment period. The deadline for plan amendments made under the Act or any related IRS or DOL regulation is the end of the first plan year beginning on or after January 1, 2025 (2027 for governmental and collectively bargained plans). In the interim, a plan that operates as if a retroactive amendment were already in effect generally will not be treated as violating the anti-cutback rules. The Act also conforms certain plan amendment deadlines under the SECURE Act, the CARES Act, and the Taxpayer Certainty and Disaster Tax Relief Act of 2020 to these new dates.

Catch up contributions of highly compensated. For tax years beginning after 2023, catch-up contributions under Code Sec. 401(k) , Code Sec. 403(b) , or Code Sec. 457(b) plans are subject to mandatory Roth tax treatment, for those made by participants whose wages for the preceding calendar year exceed $145,000, as annually indexed for inflation. This rule does not apply to simplified employee pensions under Code Sec. 408(k) , or to SIMPLE IRAs under Code Sec. 408(p) .
Even plans that do not provide a designated Roth contribution feature will now be forced to include and account for designated Roth contributions to the extent that they have employees with income that exceeds the annual limitation.

Matching or nonelective Roth contribution option. Before the Act, employers were not permitted to make matching or nonelective contributions on a Roth basis. For contributions made after December 29, 2022, however, a Code Sec. 401(a) qualified plan, a Code Sec. 403(b) plan, or a governmental Code Sec. 457(b) plan may permit a participant to designate some or all employer matching contributions and nonelective contributions as designated Roth contributions. This applies only to the extent that a participant is fully vested in these contributions.

Contribution changes for SIMPLE plans. Employers with SIMPLE plans currently must either make contributions for employees of 2% of compensation or match employee elective deferral contributions up to 3%. For tax years beginning after 2023, the Act permits an employer to make additional contributions to each employee of the plan in a uniform manner, of up to the lesser of up to 10% of compensation or $5,000 (indexed).

The Act also increases the SIMPLE annual deferral limit and the catch-up contribution at age 50 by 10%, compared to the limit that would otherwise apply in the first year this change is effective (tax years after 2023) for employers with no more than 25 employees. Employers with 26 to 100 employees could provide for higher deferral limits, but only if they either provide a 4% match or a 3% employer contribution. Similar changes to the contribution limits also apply for SIMPLE 401(k) plans.

We know that this amount of information is overwhelming, but there is much here that may affect you or your business, and induce or require you to change your retirement plan or how you handle your account and distributions. It's a lot to consider.

Be assured that we can help you with all of this. Please don't hesitate to call us for more information and our assistance.