SECURE ACT 2.0: Wow, What a Difference an Act Makes!

The Consolidated Appropriations Act of 2023 was signed into law on December 29, 2022, and has ushered in one of the most significant pieces of retirement plan legislation in recent memory. SECURE Act 2.0 (SECURE 2.0) contains a wide array of new rules impacting every kind of retirement plan. This alert will provide a brief review of some of the more significant changes enacted under SECURE 2.0. Future alerts will delve into these and other SECURE 2.0 provisions in greater depth.

Automatic Enrollment in New Retirement Plans. SECURE 2.0 requires all 401(k) plans and 403(b) plans adopted by employers on or after December 29, 2022, to include an automatic enrollment feature. All auto-enrolled participants must be enrolled at a minimum contribution rate of 3% (and no more than 10%). The contribution rate will automatically increase by 1% each year until a contribution percentage of at least 10% (but no more than 15%) is reached. Participants must be given the opportunity to opt out of the automatic enrollment and automatic escalation features and to change their deferral elections. If a participant proactively elects a specific deferral percentage, the plan should treat this election as though the employee opted out of the automatic enrollment and automatic escalation features.

Church plans, government-sponsored retirement plans, employer-sponsored retirement plans with fewer than ten employees, and employer-sponsored retirement plans that have been in existence for less than three years are exempt from the automatic enrollment/escalation rules. Further, retirement plans which were in existence prior to December 29, 2022, do not have to comply with the automatic enrollment/escalation rules (i.e., retirement plans adopted on or after December 29, 2022). Retirement plans that are subject to the automatic enrollment rules must implement the rules starting with the plan year that begins on or after January 1, 2025.

Special Treatment of Student Loan Repayments. Employees with student loan debt often struggle to make contributions to their retirement plans because of their student loan payment obligations and miss out on employer matching contributions. Effective for plan years beginning in 2024, employers will have the option to treat student loan payments made by participants as elective contributions to a 401(k) plan, 403(b) plan, or SIMPLE IRA for purposes of the employer making matching contributions to the employee's retirement plan account. SECURE 2.0 broadly defines student loan debt to include any indebtedness incurred by an employee to pay for higher education expenses (not just tuition). Employers who wish to adopt this provision will need to amend their retirement plan to take advantage of the feature.

Long-Term Part-Time Employees. Many 401(k) plans have historically excluded part-time employees by implementing a requirement that they perform at least 1,000 hours of service with the organization within a 12-month period in order to be eligible to participate in the plan. In an effort to offer more part-time workers the opportunity to save for retirement, the original Setting Every Community Up for Retirement Enhancement Act of 2019 (known as the SECURE Act) requires 401(k) plans to provide that, for plan years beginning on or after January 1, 2021, any non-union employees who (1) earned at least 500 hours of service in 3 consecutive 12-month periods and (2) are at least 21 years old at the end of the third consecutive year of service (known as a Long Term Part Time Employee) are eligible to make elective deferrals to the plan or another plan sponsored by the employer. Only service performed on or after January 1, 2021, is taken into account for purposes of this eligibility rule. As a result, the earliest date that a Long-Term Part-Time Employee can enter the plan under this rule is January 1, 2024. In addition, SECURE 2.0 has a special vesting rule in which a Long Term Part Time Employee must be credited with vesting service for each year (even those before 2021) during which the employee had 500 hours of service or more.

SECURE 2.0 reduces the minimum eligibility service from three years to two years, effective for

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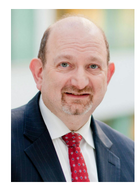

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plan years beginning on or after January 1, 2025, and extends the provision to also apply this requirement to 403(b) plans that are subject to ERISA. SECURE 2.0 also provides that pre-2021 service is disregarded for vesting purposes.

Involuntary Cash Out Amount Increased: Currently, plans can distribute a participant's benefit without their consent if the present value of the participant's vested benefit does not exceed $5,000. Beginning January 1, 2024, the limit is increased to $7,000.

Hardships: Relief for Distributions Made on Account of Federally Declared Disasters: Effective immediately, SECURE 2.0 automatically provides distribution and loan repayment relief for distributions made from tax-qualified retirement plans that are made on account of a federally declared disaster. Specifically, SECURE 2.0 allows for the first $22,000 of distributions made on account of a federally declared disaster that is withdrawn within 180 days of the disaster to be exempt from the 10% penalty on premature distributions from tax-qualified retirement plans. These distributions can be repaid to the plan without tax consequences within three years from the date of distribution.

In addition, effective retroactively to January 26, 2021, SECURE 2.0 increases the limits on loans taken from a plan on account of a federally declared disaster to the lesser of $100,000 or 100% of the vested balance for loans that are withdrawn within 180 days of the disaster. The initial loan repayments can also be delayed for loans of this nature.

Addition of Distribution Type for Emergency Expenses: Effective January 1, 2024, SECURE 2.0 permits (but does not require) retirement plans to allow participants to receive once each calendar year a distribution from a 401(k), 403(b) or 457(b) plan, up to $1,000 in order to help with emergency expenses that are unforeseeable or are immediate needs that relate to personal or family emergencies (an Emergency Distribution). Participants also have the option to repay the Emergency Distribution back to the plan within three years. Any amounts that are repaid to the plan are treated as tax-free rollover distributions. Participants who choose not to repay the distribution will not be allowed to take any other Emergency Distributions during the same three-year period.

Permits Plans to Allow Self-Certification of Hardship Distribution Eligibility: Many tax-qualified retirement plans allow participants to receive distributions from their plan accounts upon a financial hardship in which the participant has no other available resources to pay the financial hardship. Plan sponsors frequently struggle with how much documentation they need to collect from plan participants to prove both the existence of a hardship and the absence of other financial resources to pay for the financial hardship. SECURE 2.0 includes a provision that, under certain circumstances, allows employees to self-certify that they have experienced an event that constitutes a hardship for purposes of taking a hardship withdrawal.

New Penalty-Free Withdrawal for Victims of Domestic Abuse: SECURE 2.0 permits (but does not require) retirement plans to allow participants that are victims of domestic abuse to take distributions from the plan so that they can escape an unsafe situation. The provision allows participants who self-certify that they are victims of domestic abuse to withdraw the lesser of 50% of their account balance or $10,000 (as adjusted for inflation in future years). Distributions made for this purpose are not subject to the 10% penalty on pre-mature distributions. In addition, a participant has the opportunity to repay the withdrawn money over three years and can be refunded any income taxes paid on money that is repaid to the plan.

Updated Hardship Withdrawal Rules for 403(b) Plans: SECURE 2.0 permits hardship withdrawals from 403(b) plans to be made from earnings on elective deferrals, consistent with what was already permitted for hardship withdrawals from 401(k) plans.

Removal of 10% Penalty on Pre-Mature Distributions for Terminally Ill Individuals: Effective immediately, SECURE 2.0 waives the 10% penalty on pre-mature distributions for distribution to a terminally ill individual.

More Generous Self-Correction Procedures for More Types of Retirement Plans. Effective immediately, SECURE 2.0 greatly expands the correction procedures available to retirement plans under the Employee Plans Compliance Resolution System (EPCRS). Under prior guidance (i.e., Rev. Proc. 2021-30), only tax-qualified retirement plans and 403(b) plans were eligible to correct operational failures under EPCRS. Under SECURE 2.0, IRAs, SIMPLE IRAs, and

Simplified Employee Pension Plans (SEPs) can now also take advantage of EPCRS.

SECURE 2.0 also greatly expands the types of failures that can be self-corrected by allowing eligible inadvertent failures to be self-corrected at any time, even while the retirement plan is under audit, as long as the plan sponsor takes actions "which demonstrate a specific commitment to implement a self-correction" of the failure before the IRS identifies the failure.

SECURE 2.0 also provides that a loan failure that is self-corrected under EPCRS will not have to be reported as a deemed distribution on Form 1099R and will be treated as satisfying the Department of Labor's voluntary fiduciary correction program (VFCP).

SECURE 2.0 also provides updates on the correction of inadvertent benefit overpayments, including confirming that often fiduciaries will not have to recover overpayments, and generally, those overpayments can be treated as eligible rollover distributions. SECURE 2.0 provides specific rules and limitations for fiduciaries who take steps to recover overpayments.

Failures that are egregious, relate to the diversion or misuse of plan assets, or are directly or indirectly related to abusive tax avoidance transactions are not permitted to be self-corrected.

Repayment of Qualified Birth or Adoption Distributions Limited to 3 years: The law allows individuals to receive distributions of up to $5,000 from their retirement plan in the case of a birth or adoption without paying the 10% tax on pre-mature distributions and, until SECURE 2.0 these distributions could be recontributed to a retirement plan at any time. SECURE 2.0 now caps this recontribution period to a three-year period, meaning that participants may only seek a refund for amounts recontributed to the plan within three years of receiving the distribution. For any distributions previously taken, the repayment period ends on December 31, 2025.

Savings Account: In an attempt to address the lack of savings among Americans that often results in the need for hardship distributions from retirement plans, effective July 1, 2024, SECURE 2.0 permits (but does not require) plan sponsors to add a savings account feature to 401(k), 403(b), and 457(b) plans (a Personal Savings Account). Highly Compensated Employees are not eligible to have a Personal Savings Account.

Contributions up to $2,500 can be made to a Personal Savings Account on an after-tax basis through payroll deduction. Plan Sponsors may automatically enroll employees in the program for up to 3% of their compensation. Once an employee's account reaches the $2,500 cap (or a lower cap set by the plan sponsor), any additional contributions can be placed within the employee's Roth account or stopped until the balance of the Personal Savings Account falls below the cap. The contributions are treated as employee contributions for the purposes of determining an employee's eligibility for matching contributions.

To encourage the use of Personal Savings Accounts, the first four withdrawals from the account each plan year may not be subject to any distribution fees or other charges or penalties. Employees who terminate employment may take their Personal Savings Account out of the plan as cash or roll it into a Roth IRA or other 401(k), 403(b), or 457(b) plan that has a Roth feature.

Required Minimum Distribution (RMDs) Age: Effective for participants attaining age 72 after December 31, 2022, SECURE 2.0 increased the RMD Age increased from 72 to:

1. 73 for participants who attain age 72 after December 31, 2022, and
2. 75 for participants who attain age 74 after December 31, 2032.

Multiple Employer 403(b) Plans. Beginning in 2023, SECURE 2.0 allows multiple employers to participate in a single 403(b) plan (i.e., a multiple employer 403(b) plan). In addition, SECURE 2.0 eliminates the troublesome "one bad apple rule" for multiple employer 403(b) plans (formally called the unified plan rule). Under prior law, if one employer in multiple employer plans (or MEPs) violated a tax qualification rule, the MEP's tax-qualified status was jeopardized for ***all*** employers in the MEP. SECURE 2.0 has made it clear that a single employer's failure to comply with a provision of the tax code does not impact the other employers in the MEP.

Transfer to Retiree Health and Welfare Accounts. SECURE 2.0 has extended the ability to transfer excess assets to a retiree health and welfare account through December 31, 2032. Without this extension, this provision was set to expire on December 31, 2025.

Modified Small Employer Tax Credit for Retirement Plan Startup Costs: Prior to SECURE 2.0, small employers with less than 100 employees had an opportunity to qualify for a 3-year tax credit if they adopted a new retirement plan. The credit is equal to the lesser of tax expenses after (1) 50% of the administrative cost of establishing the plan or (2) $5,000. Under SECURE 2.0, effective for tax years beginning after 2023, employers with 50 or fewer employees can qualify for a tax credit equal to the lesser of 100% (instead of 50%) of the administrative costs of establishing the plan or $5,000.

New Tax Credit for Small Employer Contribution Costs: Under SECURE 2.0, employers are eligible for an additional tax credit if they:

1. employ 50 or fewer employees,
2. adopt a defined contribution plan or join a pooled or MEP,
3. adopt or join the plan after December 31, 2019, and
4. make matching contributions.

The credit covers 100% of employer matches for the first two years after the plan is adopted, then drops to 75% in the third year, 50% in the fourth year, 25% in the fifth year, and then 0% in the sixth year. Each year, the credit is capped at $1,000 per participant. However, employees making more than $100,000 annually are not taken into account. Employers with less than 50 employees are eligible for the full benefit. The credit is phased out for employers with 51 to 100 employees.

Variable Rate Premium Fixed: Under SECURE 2.0, effective immediately, the PBGC variable rate premium for single-employer plans will no longer be indexed for inflation. The premium will be fixed at $52 per $1,000 of unfunded vested benefits.