Advanced Planning Group

EYE ON CONGRESS

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SECURE 2.0 Act of 2022 – Sweeping Changes to Retirement Laws

Three years after the SECURE Act of 2019 ushered in the first major changes to the U.S. retirement system in more than a decade, more changes have now been enacted into law. Dozens of retirement-related provisions collectively known as "Setting Every Community Up for Retirement Enhancement Act of 2022" (SECURE 2.0) were included as part of a $1.7 trillion omnibus appropriations bill, Consolidated Appropriations Act, 2023 (HR 2617). The bill received approval from Congress in December and was signed into law by President Joe Biden on December 29, 2022. The effective dates for many of the provisions are immediate as of the signing of the bill, while other provisions become effective in 2023 or in subsequent years.[1]

The over 90 provisions of SECURE 2.0 are aimed at increasing access to retirement plans and retirement savings, streamlining administration and reporting requirements, and preserving retirement income. The provisions are impacting retirement plans, including 401(k) plans, 403(b) plans, 457(b) plans and defined benefit plans, as well as individual retirement accounts (IRAs). These provisions offer many new benefits to employers and employees which are designed to make it more attractive for employers to offer retirement plans and to improve retirement outcomes for employees.

This Eye on Congress (EOC) highlights key provisions of SECURE 2.0.

Highlights of SECURE 2.0 Key Provisions

1. Required Minimum Distribution (RMD) Changes.

- Age Increase. The age at which owners of retirement accounts must start taking RMDs will increase to 73, starting January 1, 2023. The current age to begin taking RMDs is 72, so individuals turning 72 in 2023 will have an additional year to delay taking a mandatory withdrawal of deferred savings from their retirement accounts. However, if a participant turned 72 in 2022 or earlier, the participant will need to continue taking RMDs as scheduled. For 2033, the age at which RMDs must start increases to 75.

[1] Regardless of the various effective dates (which impact actual plan operations), formal plan amendments reflecting these changes generally are not required to be made until the end of 2025 (for calendar year plans).

- Reduce the penalty tax for RMD failure. Starting in 2023, the steep penalty for failing to take an RMD will decrease to 25% of the RMD amount not taken, from 50% currently. The penalty will be reduced to 10% for IRA owners if the account owner withdraws the RMD amount previously not taken and submits a corrected tax return within a specified correction window.
- Eliminate RMDs from in-plan Roth Accounts. Under current law, required minimum distributions are not required to begin prior to the death of the owner of a Roth IRA. However, pre-death distributions are required in the case of the owner of a Roth designated account in an employer retirement plan (e.g., 401(k) plan). Starting in 2024, this provision allows exemption from the RMD requirements for Roth accounts in 401(k), 403(b), or governmental 457(b) plans.
- Allow a surviving spouse to elect to be treated as the employee. The surviving spouse of a participant who dies before commencing RMDs is allowed to elect to be treated as the employee for RMD purposes; thereby delaying when RMDs must commence. This provision is effective for calendar years beginning after December 31, 2023.

2. Higher Catch-Up Contributions.

- 401(k) Catch-Up. In 2023, participants age 50 and older can contribute an extra $7,500 per year annually into their 401(k) account. This amount will increase to at least $10,000 per year or 150% of the regular catch-up amount (indexed for inflation) starting in 2025 for participants age 60 to 63. However, after 2025, all catch-up contributions, for participants earning compensation over $145,000 annually, must be made on a Roth (after-tax) basis. Individuals earning compensation of $145,000 or less, adjusted for inflation going forward, will be exempt from the Roth requirement.
- IRA Catch-Up. For IRAs, the current catch-up contribution limit for people age 50 and over is $1,000. Starting in 2024, that limit will be indexed to inflation. Dependent on federally determined cost-of-living increases, this amount may increase every year.

3. Automatic Enrollment

- Employers who start new retirement plans after December 29, 2022 will, beginning in 2025, be required to automatically enroll employees in their retirement plan (with an option to opt out) at a rate of at least 3 percent, but not more than 10 percent of eligible wages. These percentages increase by prescribed amounts in later years. New companies (in business for less than three years) and employers with 10 or fewer workers are excluded from this requirement.

4. Optional Roth Treatment of Employer Contributions.

Effective immediately, employers may amend their plans to permit employees to elect that employer matching and non-elective contributions be made as Roth (after-tax) contributions, as long as the additions are 100 percent vested when contributed to the plan. Previously, matching in employer-sponsored plans were made on a pre-tax basis. Contributions to a Roth retirement plan are made after-tax, after which earnings can grow tax-free. Additional guidance is expected from the IRS.

5. Expanded Coverage for Part-time Workers.

Currently, employees who work between 500 and 999 hours for three consecutive years must be allowed to participate in their company's retirement plan. SECURE 2.0 reduces the time period to two years, effective in 2025. Note: this is not applicable to employees who participate in collectively bargained plans, or to nonresident aliens.

6. Student Loan Debt Treated as Matching Contributions.

Beginning in 2024, 401(k), 403(b) and governmental 457(b) plans may treat a student loan payment as an elective employee contribution for purposes of triggering matching contributions, giving workers an extra incentive to save while paying off educational loans.

7. Qualified Charitable Distributions (QCD).

Beginning in 2023, people who are age 70½ and older may elect as part of their QCD limit a one-time gift, (from their IRA account), up to $50,000, adjusted annually for inflation, to a charitable remainder unitrust, a charitable remainder annuity trust, or a charitable gift annuity. This is an expansion of the type of charity, or charities, that can receive a QCD. This amount counts toward the annual RMD, if applicable.

8. Distributions Allowed to Pay for Long-Term Care Contracts.

Subject to certain limits, retirement plans may permit distributions of the lesser of 10% of the account value or $2,500 annually (indexed for inflation). These distributions are exempt from the 10% early withdrawal tax and subject to income tax. A high quality LTCi policy is defined as one that has benefits indexed to inflation and has a nonforfeiture protection in place. This provision is effective three years after the date of SECURE 2.0's enactment.

9. Retirement Plan - Emergency Accounts and Emergency Withdrawals.

Beginning in 2024, SECURE 2.0 includes two approaches for employers to help employees save for short-term and unexpected expenses and access small amounts in case of financial emergencies:

- Emergency savings accounts. Employers may offer their non-highly compensated employees (generally, a person earning under $150,000 (2023, as indexed)) a pension-linked emergency savings account. Employers may automatically opt employees into these accounts at no more than 3 percent of their salary, with the portion of the account attributable to employee contributions capped at $2,500 (or a lower amount set by the employer). These contributions are treated as elective Roth contributions for purposes of a matching contribution if the plan has a matching feature. Participants must have the right to make monthly withdrawals from the account. There may not be any fees on the first 4 withdrawals each year. At separation from service, employees may take their emergency savings account as cash or roll it into a Roth DC plan or IRA.

- Withdrawals for certain emergency expenses. Subject to participant certification, a new distribution rule allows a participant to withdraw a small amount ($1,000) out of their DC (defined contribution) plan each year to meet certain emergency needs; the participant has the option of repaying it within three years. However, if repayments are not made each year, such withdrawals may be more limited. The distribution is exempt from the 10 percent premature distribution penalty tax regardless of whether it is repaid

10. 529 Plan to Roth IRAs.

For 529 Accounts that have been opened for more than 15 years, this provision allows 529 plan assets to be rolled over tax free to a Roth IRA for the beneficiary, subject to annual Roth contribution limits and an aggregate lifetime limit of $35,000. The effective date of this provision is 2024. This provision addresses the concerns regarding leftover funds being trapped in 529 accounts and resulting penalties for non-qualified withdrawals.

11. Federal Matching Contribution ("Saver's Match") for Certain Participants.

Beginning in 2027, lower-income employees will be eligible to receive a federal matching contribution of up to $1,000 per year that would be deposited into their retirement savings account. The matching contribution is 50 percent of the employee's contributions of up to $2,000 but is phased out as income increases (for example, between $41,000 and $71,000 for married, filing jointly; $20,500 to $35,500 for single taxpayers, etc.). Dependents, full-time students, nonresident aliens and individuals under 18 are not eligible. This match replaces the current Saver's Credit.

12. De Minimis Financial Incentive for Contribution to a Plan.

Effective for plan years beginning after 2022, employers may offer modest "de minimis" (depending on facts and circumstances, generally $100 or less per IRS website) financial incentives, not paid for with plan assets, such as gift cards, which may help increase participation in a 401(k) or 403(b) plan. Previously, employers could only provide matching contributions as an incentive to participate in a retirement savings plan.

13. Expand Qualifying Longevity Annuity Contracts (QLACS) Increases.

Qualified longevity annuity contracts (QLACs) are getting a boost. QLACs are deferred income annuities purchased with retirement funds typically held in an IRA or 401(k) that begin payments on or before age 85. The dollar limitation for premiums increases to $200,000 from $145,000 starting January 1, 2023. The law also eliminates the previous IRS regulation that limited premiums to 25% of an individual's retirement account balance.

14. Automatic Portability.

Beginning 2024, retirement plan service providers can provide employer plans with automatic portability services that automatically transfer a plan participant's default IRA (established in connection with a distribution from a former employer's plan) into the participant employer's retirement plan, unless the participant affirmatively elects otherwise.

15. Updating Dollar Limit for Mandatory Distributions.

Under current law, employers may transfer former employees' retirement accounts from a workplace retirement plan into an IRA if their balances are between $1,000 and $5,000. This provision increases the limit from $5,000 to $7,000, effective for distributions made after December 31, 2023.

Additional Provisions to Consider

In addition to the provisions listed above, there are many more provisions in SECURE 2.0 that will affect retirement plan sponsors and participants and some that will impact tax. A few additional provisions worth mentioning:

- Establishing a charitable organization as the remainder beneficiary of a special needs trust.
- Charitable conservation easements – deduction limitation for basis of a partner.
- Tax credits to encourage small employers to establish plans (including SEP and SIMPLE).
- Penalty exceptions for early distributions for individuals with a terminal illness and for domestic abuse survivors.
- The creation of a national online searchable lost and found database for Americans' retirement plans at the Department of Labor ("DOL") within two years of enactment.
- SIMPLE IRAs can accept Roth contributions beginning in 2023.
- Permits up to 10% deferral of gain for the amount realized upon sale of stock by S Corporation to an ESOP. This is effective for sales after 2027.
- Allows combining and splitting for determining required minimum amounts where retirement account holds both annuities and other investments. This is effective December 29, 2022. Expands use of life annuities in qualified plans and IRAs by removing required minimum distribution barriers.
- Minimum distribution failures have a 3-year statute of limitations and excess contributions have a 6-year statute limit that are effective December 29, 2022. Limitations begin upon filing of Form 1040. This is an improvement from the prior unlimited statute if Form 5329 was not filed.
- Creates a new, nonrefundable income tax credit for eligible small employers that employ military spouses and allow them to participate in the employer's defined contribution plan, subject to special eligibility and vesting requirements.

Conclusion

SECURE 2.0's broad sweep will have a lasting impact on retirement law, as it impacts virtually all types of retirement plans and provides increased opportunities for individuals to save for retirement and to more tax-efficiently access retirement accounts for other important purposes. It also provides greater flexibility and incentives for annuities within retirement plans. Many of the provisions of SECURE2.0 require additional attention and/or regulatory input from the Internal Revenue Service and the DOL. Certain provisions will have an immediate impact on plan operations in 2023, which may be impacted by any guidance that is provided.

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