Client Alert

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SECURE Act 2.0: Key Changes Retirement Plan Sponsors and IRA Owners Must Address

As last year came to an end, on December 29, 2022, President Biden signed into law the 2023 omnibus spending bill, which included a grouping of retirement plan provisions commonly referred to as the SECURE 2.0 Act of 2022 ("SECURE 2.0"). Building on the SECURE Act of 2019, SECURE 2.0 adds a number of new provisions affecting retirement plans, with the purported goal of expanding retirement plan coverage and incentivizing more people to save for retirement. These changes will require most, if not all, employer-sponsored retirement plans be amended. Therefore, plan sponsors need to be aware of the effective dates in order to timely comply with the new provisions.

Far from an exhaustive list, the following are among the most significant changes enacted by SECURE 2.0:

1. Changes to Required Minimum Distributions ("RMDs")

Prior to SECURE 2.0, plan participants or IRA owners needed to begin taking RMDs at age 70½ or face a draconian penalty of 50% of the amount that should have been distributed. The SECURE Act of 2019 increased the RMD age to 72. SECURE 2.0 further raised the RMD age to 73 in 2023 and 75 in 2033, and, effective immediately, the penalty for failure to take RMDs is reduced from 50% to 25% of the amount that was required to be taken. This penalty may be further reduced from 25% to 10% if the failure is corrected in a timely manner; that is, between the time when the penalty would be imposed and the earlier of: (1) the date the IRS initiates an audit, and (2) the end of the taxable year following the year in which the penalty would be imposed. Lastly, starting in 2024, RMDs will no longer be required from Roth accounts in employer-sponsored retirement plans. This change results in those Roth accounts having the same treatment as Roth IRAs.

2. Catch-Up Contribution Limits Raised

For plan participants between the ages of 60 and 63, SECURE 2.0 increases the catch-up contribution limit from $7,500 to the greater of $10,000, and 150% of the regular catch-up amount for a given year. In the case of SIMPLE plans, catch-up contributions are limited to $3,500. The limit increase

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becomes effective in 2025. However, beginning in 2024, plan participants earning more than $145,000 will only be able to make catch-up contributions to a Roth account with after-tax dollars.

3. Exemptions from the Early Withdrawal Penalty

Unless an exception applies, individuals who withdraw amounts from tax-deferred retirement accounts before reaching the age of 59½ are subject to a 10% excise tax. SECURE 2.0 adds various exceptions to this excise tax, including:

- Distributions of up to $1,000 for emergencies that are unforeseeable or for immediate financial needs relating to personal or family emergency purposes. Such distributions may be taken every three years, or once per year if the distribution is repaid to the account within three years.

- Distributions made to individuals who require funds in cases of domestic abuse. The distribution is limited to the lesser of $10,000 and 50% of the account balance. Furthermore, the individual may repay the distribution over three years and will be entitled to an income tax refund for any amounts repaid.

- Distributions made to terminally ill individuals.

4. Emergency Savings Accounts within Retirement Plans

Beginning in 2024, SECURE 2.0 permits plan sponsors to offer non-highly compensated employees an emergency savings account within their defined contribution retirement plans. Contributions are limited to $2,500 per year or such lower amount set by the plan sponsor, and the plan participant may withdraw such amount penalty-free. Contributions made by the plan participant must be made on a Roth-like basis, and plan sponsor contributions must be deposited into the regular account portion of the plan account at the same rate as the matching contributions. The first four withdrawals from the account each plan year may not be subject to any fees or charges solely on the basis of such withdrawals. Upon separation from service, plan participants may take their emergency savings accounts in cash or roll it into a Roth defined contribution plan account or IRA.

5. Matching Contributions for Student Loan Payments

Beginning in 2024, SECURE 2.0 authorizes plan sponsors to make matching contributions to participants' 401(k), 403(b), or SIMPLE IRA accounts for qualified student loan payments. A qualified student loan is broadly defined as any indebtedness incurred by the employee to pay for qualified higher education expenses. Plan sponsors may rely on plan participants' self-certification that the debt is a qualified student loan.

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6. Changes to 529 College Savings Plans

Effective in 2024, distributions from a 529 college savings plan that are not used for qualified education expenses are subject to income tax, while early withdrawals are subject to a 10% excise tax. SECURE 2.0 now allows for a tax-free roll over of unused assets in a 529 plan into a Roth IRA, provided that the 529 plan has been maintained for at least 15 years. Rollover contributions can be made at multiple times, subject to certain restrictions, including the following:

- Contributions (and earnings on those contributions) made to the 529 plan during the 5-year period prior to a rollover distribution are not eligible for transfer to a Roth IRA;
- The rollover contribution cannot exceed the applicable annual IRA contribution limit;
- The Roth IRA must be in the name of the 529 plan beneficiary, and
- The aggregate lifetime amount eligible for transfer is $35,000 per beneficiary.

7. Automatic Enrollment

Beginning in 2025, plans sponsors who establish new 401(k) and 403(b) plans will be required to automatically enroll eligible employees, and the initial plan contribution must be no less than 3% but no more than 10% of pretax earnings. An automatic escalation of 1% per year and up to at least 10% but no more than 15% applies to subsequent years. Plans in existence prior to 2025 will not be subject to these mandatory requirements. Additionally, plan participants may affirmatively opt out of making these default rate contributions or elect to have contributions made at a different percentage. Small businesses, new businesses, church plans and governmental plans are exempted from this requirement.

8. Plan Sponsor Contributions Allowed on a Roth Basis

Previously, plan sponsors could not make matching contributions to Roth or after-tax accounts. SECURE 2.0 now authorizes plan sponsors to provide participants with the option of receiving some or all of their matching contributions and non-elective contributions as a Roth contribution.

9. Plan Eligibility for Long-Term Part-Time Employees

The SECURE Act of 2019 made long-term part-time employees eligible to participate in 401(k) plans. Long-term part-time employees are those who have provided at least 1,000 hours of service in a 12-month period, or 500 hours of service over a period of three consecutive years. Effective for plans beginning in 2025, SECURE 2.0 reduces the consecutive three-year period to

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two consecutive years. Additionally, SECURE 2.0 makes long-term part-time employees eligible participants in 403(b) plans that are subject to ERISA.

10. Financial Incentives for Plan Participants

SECURE 2.0 eliminates the prohibition on immediate financial incentives to encourage plan participation. Effective immediately, plan sponsors may offer small financial incentives, such as small-dollar amount gift cards, to incentivize plan participation. However, such incentives may not be paid from plan assets.

In sum, SECURE 2.0 enacted many changes to retirement plans and IRA accounts that are intended to incentivize retirement savings through employer-sponsored plans. In addition, Congress included provisions that direct the U.S. Department of Labor to create an online "lost and found" database to assist plan sponsors in locating "missing" participants, as well as enabling plan participants to locate their retirement savings. This law also enhances the Employee Plans Compliance Resolution System ("ECPRS") to allow plan sponsors to correct additional plan errors through self-correction, thus saving the cost and time of more formal governmental correction programs. Some of these provisions have different delayed effective dates. Thus, plan sponsors must be aware of these changes and work closely with counsel to timely amend their plans and prepare for these changes.

Please contact the Olshan attorney with whom you regularly work or one of the attorneys below if you would like to discuss further or have any questions.

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