PUBLICATION

SECURE 2.0 Act of 2022

Authors: Andrea Bailey Powers
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The SECURE 2.0 Act of 2022 was enacted as part of the 2023 Consolidated Appropriations Act, which was signed into law on December 29, 2022. It was the culmination of a multi-year, bicameral, bipartisan effort to follow up on the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act). This is a summary of the changes most relevant to employers and their retirement plans. Where changes will be mandatory for retirement plans or the employer, we have so indicated. We expect significant administrative guidance on these changes to be forthcoming from the IRS and U.S. Department of Labor.

Changes to Employer-Sponsored Retirement Plans

Expanding automatic enrollment in retirement plans. ***Required Change.*** The Act requires newly adopted 401(k) and 403(b) plans to automatically enroll participants in the respective plans upon becoming eligible (and employees may opt out of coverage). The initial automatic enrollment amount is at least 3 percent but not more than 10 percent of compensation. Each year thereafter, that amount is increased by 1 percent until it reaches at least 10 percent, but not more than 15 percent. All current 401(k) and 403(b) plans are grandfathered in. There is an exception for small businesses with 10 or fewer employees, new businesses (i.e., those that have been in business for less than 3 years), church plans, and governmental plans. This change is effective for plan years beginning after December 31, 2024.

Expansion of coverage of part-time employees. ***Required Change.*** The 2019 SECURE Act requires an employer to allow long-term, part-time workers to participate in the employer's 401(k) plan. The SECURE Act originally provided that, except in the case of collectively bargained plans, employers maintaining a 401(k) plan must have a dual eligibility requirement under which an employee must complete either one year of service (with the 1,000-hour rule) or three consecutive years of service (where the employee completes at least 500 hours of service). The new Act reduces the three-year rule to two years, effective for plan years beginning after December 31, 2024. The Act also provides that pre-2021 service is disregarded for vesting purposes. This provision also extends the long-term, part-time coverage rules to 403(b) plans that are subject to ERISA.

Increase in age for required beginning date for required minimum distributions (RMDs). ***Required Change.*** Under current law, participants are generally required to begin taking distributions from their retirement plans at age 72. Starting in 2023, the Act delays the first required minimum distribution (RMD) from tax-advantaged retirement accounts, such as a traditional IRA, SEP IRA, or SIMPLE IRA, or an employer-sponsored retirement plan, such as a 401(k) plan, from age 72 to 73. Then, in 2033, the RMD age will increase again, to 75.

While RMDs are not required for Roth IRAs under current law until the owner of the Roth IRA dies, pre-death distributions are required for Roth money in an employer's 401(k) plan. The Act eliminates the pre-death distribution requirement effective for taxable years beginning after December 31, 2023 but does not apply to required distributions from years before January. 1, 2024, that are allowed to be paid on or after that date.

The Act also reduces the penalty for failing to take RMDs from 50 percent to 25 percent, or 10 percent if the error is corrected in a timely manner.

Increase in catch-up limit. Beginning in 2025, the maximum number of catch-up contributions in employer-sponsored retirement plans (401(k) and 403(b)) will increase to $10,000 per year or 50 percent more than the regular catch-up amount, whichever is greater, for those participants ranging in age from 60 to 63. Retirement plan catch-up contributions will be required in the form of Roth contributions for participants with wages greater than $145,000 in the previous year (as indexed). IRA catchups will change as well. Starting in 2024, IRA catchups will be indexed to inflation. Under current law, these catchups are limited to $1,000 (not indexed) for those aged 50 and over.

Matching contributions for student loan payments. For plan years beginning after December 31, 2023, the Act permits employers to make matching contributions with respect to "qualified student loan payments" under a 401(k) plan, 403(b) plan, or SIMPLE IRA. A qualified student loan payment is broadly defined as any indebtedness incurred by the employee solely to pay qualified higher education expenses of the employee. Governmental employers are also permitted to make matching contributions in a 457(b) plan or other plan with respect to such repayments. For purposes of the nondiscrimination test applicable to elective contributions, the Act permits a plan to test the employees separately who receive matching contributions for student loan repayments.

Permitted inducements for contributing to a plan. Under current law, employers may provide matching contributions as a long-term incentive for employees to contribute to a 401(k) plan. However, any other inducements or financial incentives (like gift cards in small amounts) are prohibited, even though individuals may be especially motivated by them to join their employers' retirement plans. The Act now enables employers to offer de minimis financial incentives, not paid for with plan assets, such as low-dollar gift cards, to boost employee participation in workplace retirement plans by exempting de minimis financial incentives from Internal Revenue Code Section 401(k)(4)(A) and from the corresponding rule under Section 403(b). This change is effective for plan years that began after December 29, 2022.

Exemption for certain automatic portability transactions. Under current law, an employer is permitted to distribute a participant's account balance without participant consent if the balance is under $5,000 and the balance is immediately distributable (e.g., after a termination of employment). Current law also requires an employer to roll over this distribution into a default IRA if the account balance is at least $1,000 and the participant does not affirmatively elect otherwise. The Act permits a retirement plan service provider to provide employer plans with automatic portability services. These services involve the automatic transfer of a participant's default IRA (established in connection with a distribution from a former employer's plan) into the participant's new employer's retirement plan, unless the participant affirmatively elects otherwise. This change is effective for transactions occurring on or after December 28, 2023.

Saver's Match. Current law provides for a nonrefundable credit for certain individuals who make contributions to individual retirement accounts (IRAs), employer retirement plans (such as 401(k) plans), and ABLE accounts. The Act repeals and replaces this credit with respect to IRA and retirement plan contributions, changing it from a credit paid in cash as part of a tax refund into a federal matching contribution that must be deposited into a taxpayer's IRA or retirement plan. The match is 50 percent of IRA or retirement plan contributions up to $2,000 per individual. The match phases out between $41,000 and $71,000 of income for taxpayers filing a joint return ($20,500 to $35,500 for single taxpayers and married filing separate; $30,750 to $53,250 for head of household filers). The change is effective for taxable years beginning after December 31, 2026.

Withdrawals for certain emergency expenses. ***Mandatory Change.*** Generally, an additional 10 percent penalty tax applies to early distributions from pre-tax and matching contributions to retirement accounts, such as 401(k) plans and IRAs, unless an exception applies. The Act provides an exception for certain distributions used for emergency expenses that are unforeseeable or immediate financial needs relating to personal or

family emergency expenses. Only one distribution is permissible per year, of up to $1,000, and a taxpayer has the option to repay the distribution within three years. No further emergency distributions are permissible during the three-year repayment period unless repayment occurs. The change is effective for distributions made after December 31, 2023.

Emergency savings accounts linked to individual account plans. The Act permits employers the option to offer to their non-highly compensated employees emergency savings accounts that are linked to a retirement plan. Employers may automatically opt employees into these accounts at no more than 3 percent of compensation, capped at $2,500. Once the cap is reached, any additional contributions can be directed to the employee's retirement plan account or stopped until the balance attributable to contributions falls below the cap. Contributions are made on a Roth-like basis and are treated as elective deferrals for purposes of retirement matching contributions with an annual matching cap set at the maximum account balance – i.e., $2,500 or lower as set by the plan sponsor. 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. At separation from service, employees may take their emergency savings accounts as cash or roll them into another qualified plan or IRA. This change is effective January 1, 2024.

Application of top-heavy rules to defined contribution plans covering excludable employees. Under current law, plans that are deemed top-heavy are required to provide all employees with a minimum top-heavy contribution (usually 3 percent of compensation). Other nondiscrimination tests that apply to 401(k) plans allow an employer to test otherwise excludable employees (e.g., those who are under age 21 and have less than 1 year of service) separately. This was intended to encourage plan sponsors to permit employees to defer earlier than the minimum age and service conditions permitted under the law because it reduces the situations where plans would fail the nondiscrimination tests if these employees were included when performing the test. However, this separate testing is not allowed for the top-heavy test. The Act allows an employer to perform the top-heavy test separately on the non-excludable and excludable employees. This removes the financial incentive to exclude employees from the 401(k) plan and increases retirement plan coverage to more workers. This change is effective for plan years beginning after December 31, 2023.

Employers may rely on employee certification that deem hardship distribution conditions are met. The Act provides that, under certain circumstances, employees are permitted to self-certify that they have had an event that constitutes a hardship for purposes of taking a hardship withdrawal. The change is effective for plan years as of December 29, 2022.

Penalty-free withdrawal from retirement plans for individual case of domestic abuse. A domestic abuse survivor may need to access their money in their retirement account for various reasons, such as escaping an unsafe situation. The Act allows retirement plans to permit participants who self-certify that they experienced domestic abuse to withdraw a small amount of money (the lesser of $10,000, indexed for inflation, or 50 percent of the participant's account). The distribution will not be subject to the 10 percent tax on early distributions. In addition, a participant has the opportunity to repay the withdrawn money from the retirement plan over three years and will be refunded for income taxes on money that is repaid. The change is effective for distributions made after December 31, 2023.

Amendments to increase benefit accruals under plan for previous plan year allowed until employer tax return due date. The SECURE Act permits an employer to adopt a new retirement plan by the due date of their tax return for the fiscal year in which the plan is effective. Current law, however, provides that plan amendments to an existing plan must generally be adopted by the last day of the plan year in which the amendment is effective. This precludes an employer from adding plan provisions that may be beneficial to participants. The Act amends these provisions to allow discretionary amendments that increase participants'

benefits to be adopted by the due date of the employer's tax return. The change is effective for plan years beginning after December 31, 2023.

Starter 401(k) plans for employers with no retirement plan. The Act permits an employer that does not sponsor a retirement plan to offer a starter 401(k) plan (or safe harbor 403(b) plan). A starter 401(k) plan (or safe harbor 403(b) plan) would generally require that all employees be automatically enrolled in the plan at a 3 to 15 percent of compensation deferral rate. The limit on annual deferrals would be the same as the IRA contribution limit, which is $6,000 for 2022 with an additional $1,000 in catch-up contributions beginning at age 50. The Act is effective for plan years beginning after December 31, 2023.

Recovery of retirement plan overpayments. Sometimes retirees mistakenly receive more money than they are owed under their retirement plans. These mistakes cause problems when they occur over time and plan fiduciaries later seek to recover the overpayments from unsuspecting retirees. When an overpayment has lasted for years, plans often compel retirees to repay the amount of the overpayment, plus interest, which can be substantial. Even small overpayment amounts can create a hardship for a retiree living on a fixed income. The Act provides retirement plan fiduciaries the latitude to decide not to recoup overpayments that were mistakenly made to retirees. This change is effective immediately.

Missing plan participants. The Act creates a national online searchable lost-and-found database for Americans' retirement plans at the U.S. Department of Labor (DOL). The database will enable participants to search for the contact information of their plan administrator. The DOL is directed to create this database no later than two years after the date of enactment of this Act.

Enhancement of 403(b) plans. Under current law, 403(b) plan investments are generally limited to annuity contracts and publicly traded mutual funds. This limitation cuts off 403(b) plan participants – generally, employees of charities and public schools, colleges, and universities – from access to collective investment trusts, which are often used by 401(a) plans to expand investment options for plan participants at a lower overall cost. The Act permits 403(b) custodial accounts to participate in group trusts with other tax-preferred savings plans and IRAs, effective immediately.

Expansion of Employee Plans Compliance Resolution System. The Act expands the IRS retirement plan correction program – the Employee Plans Compliance Resolution System (EPCRS) – to (1) allow more types of errors to be corrected internally through self-correction, (2) apply to inadvertent IRA errors, and (3) exempt certain failures to make required minimum distributions from the otherwise applicable excise tax.

Changes to Small-Employer Retirement Plans

Allow additional non-elective contributions to SIMPLE plans. Current law requires employers with SIMPLE plans to make employer contributions to employees of either 2 percent of compensation or 3 percent of employee elective deferral contributions. The Act permits an employer to make additional contributions to each employee of the plan in a uniform manner, provided that the contribution may not exceed the lesser of up to 10 percent of compensation or $5,000 (indexed). The change is effective for taxable years beginning after December 31, 2023.

Multiple employer 403(b) plans. Multiple employer plans (MEPs) provide an opportunity for small employers to band together to obtain more favorable retirement plan investment results and more efficient and less expensive management services. The 2019 SECURE Act made MEPs more attractive by eliminating outdated barriers to using them and improving the quality of MEP service providers. The Act allows 403(b) plans, which are generally sponsored by charities, educational institutions, and nonprofits, to participate in MEPs and PEPs, including relief from the "one bad apple" rule so the violations of one employer do not affect the tax treatment

of employees of compliant employers. This change is effective for plan years that began after December 31, 2022.

Military spouse retirement plan eligibility credit for small employers. Military spouses often do not remain employed long enough to become eligible for their employer's retirement plan or to vest in employer contributions. The Act provides small employers a tax credit with respect to their defined contribution plans if they (1) make military spouses immediately eligible for plan participation within two months of hire; (2) upon plan eligibility, make the military spouse eligible for any matching or non-elective contribution that they would have been eligible for otherwise at two years of service; and (3) make the military spouse 100 percent immediately vested in all employer contributions. The tax credit equals the sum of (1) $200 per military spouse and (2) 100 percent of all employer contributions (up to $300) made on behalf of the military spouse, for a maximum tax credit of $500. This credit applies for three years with respect to each military spouse – and does not apply to highly compensated employees. An employer may rely on an employee's certification that such employee's spouse is a member of the uniformed services. The change is effective for taxable years beginning after the date of enactment of this Act.

Contribution limit for SIMPLE plans. Under current law, the annual contribution limit for employee elective deferral contributions to a SIMPLE IRA plan is $14,000 (2022) and the catch-up contribution limit beginning at age 50 is $3,000. A SIMPLE IRA plan may only be sponsored by a small employer (100 or fewer employees), and the employer is required to either make matching contributions on the first 3 percent of compensation deferred or an employer contribution of 2 percent of compensation (regardless of whether the employee elects to make contributions). The Act increases the annual deferral limit and the catch-up contribution at age 50 by 10 percent, as compared to the limit that would otherwise apply in the first year this change is effective, in the case of an employer with no more than 25 employees. An employer with 26 to 100 employees would be permitted to provide higher deferral limits, but only if the employer either provides a 4 percent matching contribution or a 3 percent employer contribution. The Act makes similar changes to the contribution limits for SIMPLE 401(k) plans. The change is effective for taxable years beginning after December 31, 2023.

Employers allowed to replace SIMPLE retirement accounts with safe harbor 401(k) plans during a year. The Act allows an employer to replace a SIMPLE IRA plan with a SIMPLE 401(k) plan or other 401(k) plan that requires mandatory employer contributions during a plan year and is effective for plan years beginning after December 31, 2023.

Tax Credits for Small Employers

Small-employer pension plan start-up cost credit. The three-year small business start-up credit is currently 50 percent of administrative costs, up to an annual cap of $5,000. The Act changes the credit by increasing the start-up credit from 50 percent to 100 percent for employers with up to 50 employees. Except in the case of defined benefit plans, an additional credit is provided. The amount of the additional credit generally will be a percentage of the amount contributed by the employer on behalf of employees, up to a per-employee cap of $1,000. This full additional credit is limited to employers with 50 or fewer employees and phased out for employers with between 51 and 100 employees. The applicable percentage is 100 percent in the first and second years, 75 percent in the third year, 50 percent in the fourth year, 25 percent in the fifth year, and no credit for tax years thereafter. The change is effective for taxable years that began after December 31, 2022.

Application of credit for small employer pension plan startup costs to employers which join an existing plan. The Act ensures the startup tax credit is available for three years for employers joining a MEP, regardless of how long the MEP has been in existence. Under both pre- and post-SECURE Act law, the start-up tax credit only applies for the first three years that a plan is in existence. For example, if a small business joins a MEP that has already been in existence for three years, the start-up credit is not available. If, for example, the MEP has been existence for one or two years when a small business joins, the small business

may be able to claim the credit for one or two years, respectively. The Act fixes this issue so employers joining a MEP (which includes PEPs) are eligible for the credit for all three years. The change is effective retroactively for taxable years after December 31, 2019.

Changes to ESOPs

Deferral of tax for certain sales of employer stock to employee stock ownership plan sponsored by S Corporation. Under Internal Revenue Code Section 1042, an individual owner of stock in a non-publicly traded C Corporation that sponsors an employee stock ownership plan (ESOP) may elect to defer the recognition of gain from the sale of such stock to the ESOP if the seller reinvests the sales proceeds into qualified replacement property, such as stock or other securities issued by a U.S. operating corporation. After the sale, the ESOP must own at least 30 percent of the employer corporation's stock. This change expands the gain deferral provisions of Code Section 1042 with a 10 percent limit on the deferral to sales of employer stock to S Corporation ESOPs. This change is effective for sales made after December 31, 2027.

Certain securities treated as publicly traded in case of employee stock ownership plans. The Act updates certain ESOP rules related to whether a security is a "publicly traded employer security" and "readily tradeable on an established securities market." The Act allows certain non-exchange traded securities to qualify as publicly traded employer securities as long as the security is subject to priced quotations by at least four dealers in a Securities and Exchange Commission-regulated interdealer quotation system, is not a penny stock and is not issued by a shell company and has a public float of at least 10 percent of outstanding shares. For securities issued by domestic corporations, the issuer must publish annual audited financial statements. Securities issued by foreign corporations are subject to additional depository and reporting requirements. The updated definitions will allow highly regulated companies with liquid securities that are quoted on non-exchange markets to treat their stock as "public" for ESOP purposes, thus making it easier for these companies to offer ESOPs to their U.S. employees. The change is effective for plan years beginning after December 31, 2027.

Changes to ERISA Reporting and Disclosure

Performance benchmarks for asset allocation funds. The DOL's participant disclosure regulation requires that each designated investment alternative's historical performance be compared to an appropriate broad-based securities market index. However, the rule does not adequately address increasingly popular investments like target date funds that include a mix of asset classes. The Act directs the Secretary of Labor to update the DOL's regulations so an investment that uses a mix of asset classes can be benchmarked against a blend of broad-based securities market indices, provided (a) the index blend reasonably matches the fund's asset allocation over time, (b) the index blend is reset at least once a year, and (c) the underlying indices are appropriate for the investment's component asset classes and otherwise meet the rule's conditions for index benchmarks. This change in the disclosure rule allows better comparisons and aids participant decision-making. The DOL is to update its regulations no later than two years after enactment of this Act. The change also requires DOL to report to Congress on the effectiveness of its benchmarking requirements no later than three years after the applicability date of the regulations.

Eliminating unnecessary plan requirements related to unenrolled participants. Under current law, employees eligible to participate in a retirement plan are required to receive a broad array of notices that are intended to inform them of their various options and rights under the plan. In the case of eligible employees who have not elected to participate in the plan (unenrolled participants), these notices – such as notices regarding the different investment options available under the plan – are generally unnecessary and can even have adverse effects on savings and coverage.

The Act no longer requires employers provide certain intermittent ERISA or Code notices to employees who have not elected to participate in a workplace retirement plan. However, to further encourage participation of

such employees, the plan is required to send (1) an annual reminder notice of the participant's eligibility to participate in the plan and any applicable election deadlines, and (2) any otherwise-required document requested at any time by the participant. This rule applies only with respect to an unenrolled participant who received the summary plan description, in connection with initial eligibility under the plan, and any other notices related to eligibility under the plan required to be furnished. This change is effective for plan years that began after December 31, 2022.

Requirement to provide paper statements in certain cases. The Act amends ERISA to generally provide that, with respect to defined contribution plans, unless a participant elects otherwise, the plan is required to provide a paper benefit statement at least once annually. The other three quarterly statements required under ERISA are not subject to this rule (i.e., they can be provided electronically). For defined benefit plans, unless a participant elects otherwise, the statement that must be provided once every three years under ERISA must be a paper statement. The Labor Secretary must update the relevant sections of their regulations and corresponding guidance by December 31, 2024, and the annual paper statement is effective for plan years beginning after December 31, 2025.

If you have questions about this alert, please contact Andrea Powers or one of the members of Baker Donelson's ERISA Litigation Group.