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Employee Benefits & Executive Compensation

January 6, 2023

SECURE 2.0 Legislation: Impact on Qualified Plans

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On December 29, 2022, President Biden signed into law the federal omnibus spending bill titled the Consolidated Appropriations Act, 2023. Included in the omnibus bill is the SECURE 2.0 Act of 2022, which builds on the tax legislation approved in 2019 called the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE 1.0).

SECURE 2.0 includes a number of provisions that are intended to expand retirement plan coverage and increase retirement savings. Sponsors of tax-qualified plans will need to take stock of these changes and in most instances will also need to amend their plans (though not immediately).

The chart below briefly summarizes elements of SECURE 2.0 that are most likely to impact employers' tax-qualified plans and provides some observations about the changes for those affected by the new law to consider:

Topic	Existing Law	SECURE 2.0	Observations/Comments
Automatic Enrollment	Employers may, but are not required to, include an automatic enrollment feature in a 401(k) plan (that is, a provision that automatically enrolls eligible employees at a given percentage of pay unless the employee opts out). Employers also may, but are not required to, allow auto-enrolled participants to withdraw within 90 days after commencement and withdraw their contributions.	The new law makes automatic enrollment mandatory. Under the law, 401(k) plans must automatically enroll eligible employees at a contribution rate of no less than 3 percent and no more than 10 percent of compensation, with annual automatic 1 percent increases until the participant's contribution reaches at least 10 percent, but no more than 15 percent, of compensation. A participant must also be allowed to affirmatively opt out of the automatic contribution or automatic increases or elect to make contributions at a different percentage. The new law also requires that participants have the ability to cancel automatic enrollment within 90 days after beginning and withdraw the contributions they have made. This requirement is effective for plan years beginning after December 31, 2024, but is not required for: (i) plans established before December 29, 2022; (ii) any plan maintained by an employer in existence for less than three years (including any predecessor employer); (iii) any plan maintained by an employer that employs not more than 10 employees; and (iv) "SIMPLE" plans, governmental plans, and certain other plans.	Since SECURE 2.0 makes automatic enrollment mandatory only for plans that were not in effect on December 29, 2022, sponsors of existing 401(k) plans need not add an automatic enrollment feature to their plans. Of course, plan sponsors may consider doing so.

Catch-up Contribution Limits	For 2023, the catch-up contribution limit for 401(k) and 457(b) plans for those age 50 or older is $7,500. Individual retirement accounts (IRAs) have a $1,000 catch-up limit, which is not indexed for inflation.	Effective beginning January 1, 2025, the new law increases the catch-up contribution limit for individuals who have attained ages 60, 61, 62, and 63 to the greater of $10,000 or 50 percent more than the regular catch-up amount in 2024. The new law adjusts IRA catch-up contributions for inflation, beginning January 1, 2024.	The increased catch-up contribution can enable individuals who are nearing retirement to add to their retirement savings. However, as described in the next row, participants must be aware that, beginning in 2024, if their wages for the prior year exceed $145,000 (adjusted for inflation), any catch-up contributions they make will be treated as Roth contributions.
Catch-up Contributions Treated as Roth Contributions	Under existing law, catch-up contributions may be made as regular pretax contributions or, if the plan permits, as Roth contributions. Roth contributions are made on an after-tax basis and if deferred until a qualified distribution occurs, neither the Roth contributions nor their earnings are taxable.	Effective January 1, 2024, the new law requires that any catch-up contributions under a 401(k) or 457(b) plan be treated as Roth contributions if made by participants whose wages for the preceding calendar year are more than $145,000, as annually adjusted for inflation.	Both participants and employers should be mindful of this new requirement. For employers, especially those that have plans that do not permit Roth contributions, administrative procedures should be established to avoid having a participant's catch-up contributions reclassified as Roth contributions. Employees earning more than $145,000 could also be caught unaware if they believe they are making catch-up contributions on a pretax basis.
Treatment of Matching and Nonelective Contributions as Roth Contributions	Under existing law, an employer cannot make matching or nonelective contributions as Roth contributions.	The new law allows an employer to permit a participant to designate some or all fully vested matching and nonelective contributions as Roth contributions, effective for contributions made after the December 29, 2022.	This feature may be of interest to participants, particularly those who have already opted for an in-plan Roth conversion or are making ongoing Roth contributions. A plan amendment will be needed if an employer desires to implement this change.
Required Minimum Distributions (RMD)	In general, RMDs from tax-qualified plans must begin by April 1 of the year following the later of the year in which a participant reaches age 72 or retires. However, participants who own a 5 percent or greater interest in the employer must begin receiving RMDs by April 1 of the year following the year in which they reach age 72 regardless of whether or not they are retired. Owners of IRAs also are required to begin receiving RMDs by April 1 of the year after the year in which they reach age 72. A 50 percent penalty tax is imposed on individuals who fail to timely receive an RMD.	The new law defers the RMD age for both tax-qualified plans and IRAs from 72 to 73 beginning January 1, 2023, and from age 73 to 75 beginning January 1, 2033. The penalty tax for failing to take RMDs is reduced to 25 percent (and in some instances to 10 percent), effective for taxable years beginning after December 29, 2022. Effective January 1, 2024, RMDs will no longer be required from Roth accounts in employer retirement plans.	This change will benefit individuals who wish to delay the time at which they begin drawing down on their retirement savings under tax-qualified plans and IRAs, allowing them to accumulate additional tax-deferred earnings on their retirement savings. Of course, for tax-qualified plans, the terms of the plans will control how long retirees may defer receipt of benefits. Plan sponsors, many of whom just updated their plans and administrative procedures to increase the RMD age from 70½ to 72 pursuant to SECURE 1.0, will need to amend their plans and adjust administrative procedures again to reflect the SECURE 2.0 change.

Long-Term Part-time Employees	Under SECURE 1.0, long-term part-time employees must be eligible to participate in a 401(k) plan. An individual qualifies as a long-term part-time employee if he or she has at least (i) 1,000 hours of service in a 12-month period or (ii) 500 hours of service in a three-year consecutive period. This requirement became effective for plan years beginning in 2021, but service recognized before 2021 need not be counted. Thus, the true effective date is for plan years beginning in 2024.	Under the new law, the three-year consecutive period is reduced to two consecutive years. Effective for plan years beginning after December 31, 2024.	Employers that have been planning for the long-term part-time employee requirement to take effect will need to further assess and prepare for the new change, which for most will be effective for the plan year beginning January 1, 2025.
Increase in Automatic Rollover Limit	A distribution under a tax-qualified plan that is payable to a former participant may be automatically rolled over to an IRA if the amount of the distribution is between $1,000 and $5,000.	Under the new law, an automatic rollover may be made if the amount is between $1,000 and $7,000. Effective for distributions made after December 31, 2023.	This change will enable plan sponsors to force out relatively small benefits. For pension plans, that can reduce PBGC premiums and administrative expenses. A plan amendment will be needed if an employer desires to implement this change.
Withdrawals	Generally, distributions from qualified plans and IRAs prior to age 59½ result in a 10 percent penalty tax. Exceptions currently exist for, among other things, distributions due to death or disability and to cover certain medical expenses.	Under the new law, the 10 percent early distribution penalty tax will not apply to withdrawals of up to $1,000 for "unforeseeable or immediate financial needs relating to necessary personal or family emergency expenses." Only one withdrawal may be made every three years or every year if the distribution is repaid within three years. The early distribution penalty tax will also not apply to distributions that do not exceed the lesser of (i) $10,000 (as adjusted for inflation) or (ii) 50 percent of the present value of the individual's nonforfeitable accrued benefit for individuals who need the funds due to domestic abuse or terminal illness. These changes are effective for distributions made after December 31, 2023.	These changes may aid participants who wish to take an early distribution in order to cover expenses incurred for an unforeseeable or immediate personal or family emergency, domestic abuse, or terminal illness.
Matching Contributions on Student Loan Repayments	No existing provision.	Under the new law, if desired, an employer may make matching contributions on student loan repayments as if the student loan repayments were elective deferrals. Effective for plan years beginning after December 31, 2023.	Congress indicated that this change is intended to help employees who are unable to save for retirement because of student debt obligations by enabling employers to credit them with the matching contributions they would have received had their student loan repayments been elective deferrals to the plan. A plan amendment will be needed to implement this change.

Emergency Saving Accounts	No provision.	The new law allows an employer to amend its plan to allow non-highly compensated employees to defer (post-tax) up to the lesser of (i) 3 percent of compensation or (ii) $2,500 to an emergency savings account. These contributions may be made via an automatic contribution arrangement and may be matched. Unused funds in the emergency account are distributable following separation from service and may be rolled over to a Roth IRA. Effective for plan years beginning after December 31, 2023.	It's not clear from the legislation what emergencies will qualify for withdrawals or whether any emergency is actually required. Funds withdrawn, however, are not subject to the 10 percent early distribution penalty tax discussed above.
Financial Incentives to Participate	No provision.	The new law allows an employer to offer small financial incentives (such as gift cards) to encourage participation in retirement plans. Effective for plan years beginning after December 29, 2022.	This change will allow employers to offer small gifts/rewards in return for an employee's participation in a 401(k) plan. That could prove to be a useful tool in motivating employees to participate. The legislation does not specifically state that small financial incentives can be used to incent participants to increase their contributions. Perhaps that will be addressed in further guidance.
Missing Participants	No provision.	The new law creates a national online database to aid employers to locate "missing" plan participants and for plan participants to locate retirement funds.	Dealing with unclaimed pension benefits always starts with making all reasonable attempts to locate lost participants. Hopefully, this database will prove a helpful tool in that effort.

Some of the changes summarized above that affect tax-qualified plans will require that employers amend their plans. Under SECURE 2.0, amendments are generally not required until January 1, 2024 (or later), but employers that wish to implement some changes permitted by SECURE 2.0 will, as a practical matter, likely need to amend their plans at the time those changes are implemented. Employers and plan administrators should watch for additional Client Alerts from us regarding the content and timing of appropriate amendments as anticipated guidance from the IRS is issued.

In addition to the changes that impact tax-qualified plans, there are a few other benefits-related items addressed in SECURE 2.0 that are worth noting. SECURE 2.0 extends through December 31, 2024, the temporary relief provided by the CARES Act that allows for telehealth and other remote care services to be provided at little or no cost under a high deductible health plan. In addition, effective beginning in 2028, SECURE 2.0 allows S corporation shareholders to defer the gain on sales of their stock to an employee stock ownership plan (ESOP), as is currently allowed for shareholders of C corporations. However, unlike for C corporations, the S corporation rule limits the deferral to no more than 10 percent of the sale proceeds.

As indicated above, SECURE 2.0 made a number of changes that will influence retirement planning and plan design. Our Employee Benefits & Executive Compensation practice group attorneys are ready to assist with any questions you may have and to advise on how best to address te effects of SECURE 2.0 on your plans.

Contacts

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