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SECURE ACT 2.0: WHAT YOU NEED TO KNOW

On December 29, 2022, President Biden signed the Consolidated Appropriations Act, 2023. The SECURE Act 2.0, as it's known, expanded and clarified the Setting Every Community Up for Retirement Enhancement Act (SECURE Act) of 2019. The SECURE Act created and gave additional incentives for employers and employees to participate along with provision providing COVID-19 relief on distribution. For a summary of the SECURE Act, click here.

The SECURE Act 2.0 contains over 90 provisions expanding coverage and increasing retirement savings, simplifying, and clarifying retirement plan rules, making technical amendments to the original SECURE Act, and changing some administrative, revenue, and tax court retirement provisions. Some provisions are mandatory, some are optional and all available for different years.

The key to understanding the many provisions is to first find out what year the provisions are effective and if the provisions are mandatory. Finally, understanding the optional provisions and whether your client will want to add them to their existing or new plans. In addition, there are rules and incentives for new plans.

Given the size and scope of this law, we have created a useful chart which shows the requirements for each provision by effective date.

PROVISIONS FOR NEW PLANS

Solo 401(k) Plans. Self-employed individuals (Sole Proprietors and Partnerships) now have until they file their tax returns to adopt and fund contributions including 401(k) salary deferrals. Prior to the change, they could only fund employer contributions when their plan was adopted after the end of the plan year.

Small Employer Start-up Tax Credits. The existing new plan Start-up Tax Credit for employers with 1 to 50 employees increased from 50 to 100% of plan expenses with an annual cap of $5,000. The SECURE Act 2.0 establishes an Employer Contribution Tax Credit for plan contributions made by the employer. The credit is a percentage of the employer contribution up to $1,000 per employee, provided the employee earned $100,000 or less during the plan year. The percentages are 100% for the first two years, 75% for the third year, 50% for the fourth year, and 25% for the fifth year.

Automatic Enrollment. For plan years beginning after December 31, 2024, an employer who has been in existence for at least three years with more than 10 employees must automatically enroll participants unless the employee opts out when starting a new 401(k) plan. Under these rules, employees will start with a salary deferral of at least 3% of compensation. The rate of salary deferral increases annually by 1% of compensation until reaching at least 10%, but no more than 15% of compensation.

PROVISIONS FOR ALL PLANS

Here is a quick explanation of the various provisions available to all plans.

Roth accounts. Designated Roth accounts in employer plans are encouraged under the new law. These accounts within 401(k) plans are no longer subject to required minimum distribution (RMD) rules. This change mirrors the provisions of Roth IRAs.

Coverage of Long-Term Part-time Employees. In 2019, the SECURE Act changed provision to allow long-term part-time employees with three consecutive years of service of at least 500 hours to enter a 401(k) plan. They would only be eligible for 401(k) salary deferrals. No employer contribution is required. Under the SECURE Act 2.0, only two consecutive years of service of 500 hours are required. For transition purposes, pre-2021 service employees are disregarded for eligibility and vesting rules. The participant will receive one year of vesting service for each plan year in which they work at least 500 hours.

Incentives to Participate. Prior to the SECURE Act 2.0, an employer could not offer incentives to encourage employees to contribute to a retirement savings plan. For plan years beginning after December 29, 2022, an employer is allowed to offer de minimis, immediate financial incentives to encourage employees to join retirement plans. De minimis is not defined in the new code so we will have to await further guidance on what is allowed. Time will tell.

Overfunded Defined Benefit Plans. Many employers have overfunded defined benefit plans and find it beneficial to transfer excess assets to an account to pay retiree health benefits. Those provisions, which would have expired after 2025, have been relaxed and extended until 2032.

Correcting Errors. The SECURE Act 2.0 greatly expands methods and reasons for self-corrections. For existing programs, click (correction programs) . Administrative errors that include over payments, along with vesting, participation and other errors may be self-corrected as opposed to getting IRS approval. Retroactive amendments are allowed to fix the errors made. The law provides a grace period for making corrections of nine and a half months after the end of the plan year in which the mistake was made for any error occurring after 2023.

Required Minimum Distribution (RMD) Rules. Individuals turning age 72 during 2023 or later will start their required minimum distributions at age 73. For those reaching age 74 after December 31, 2032, their RMD starts at age 75.

RMD Penalty Relief. If required minimum distributions are not taken, the excise tax penalty is reduced from 50 to 25% for taxable years beginning in 2023. The penalty is further reduced to 10% if correction is made within two years after the end of the taxable year in which the distribution was missed.

Catch-up Contributions. Individuals age 50 and older can contribute a salary reduction catch-up contribution. The current catch-up contribution is limited to $7,500 annually. For tax years beginning after 2024, employees who are 60-63 years old can contribute a higher catch-up contribution of the greater of $10,000 or 50% more than the regular catch-up limit.

Annuity Investment Option. Annuity Contracts will be more readily available within employer plans. Plan participants in account balance plans may want to use a portion of retirement plan savings to purchase annuities.

Student Loan Repayment. Beginning in 2024 with the SECURE Act 2.0, an employee's student loan debt repayment can be treated as the employee's salary deferral to a 401(k) plan. This is an option that an employer can add to their retirement plan.

Emergency and Disaster Relief. The new law clarifies early ones that allowed employers to add provisions to their plans to help non-highly compensated employees save for emergencies. Employee contributions to these new emergency savings accounts are generally limited to no more than $2,500. The SECURE Act 2.0 also allows plan participants to withdraw up to $1,000 annually for meeting unforeseeable emergencies. These distributions are not subject to the 10% penalty for early withdrawal. Only one distribution can be made per year. An employee can repay the amount to the plan within three years.

Effective for disasters after December 27, 2020, The SECURE Act 2.0 permanently exempts plan distributions from the 10% penalty for early withdrawal of up to 22,000 for bona fide disaster losses. In addition, a participant can borrow from the qualified plan up to a maximum of $100,000 for disaster relief. A qualifying disaster-related distribution can be repaid over three years.

In conclusion, it appears the IRS and DOL are trying to increase participation in small employer plans by offering increased tax incentives, more uses of 401(k) money, auto-enrollment, increased catch-up contributions and emergency relief distributions. Corrective relief will be a great help in fixing mistakes and moving on. Tracking distributions for disaster and emergency relief can be problematic.

Understanding which provisions apply when and what benefits they can provide is crucial to understanding how the SECURE Act 2.0 will affect our clients.

Please note this is a brief summary and not an exhaustive list. For more information, check out our additional articles here.