JANUARY 23, 2023

BENEFITS & COMPENSATION UPDATE

*SECURE 2.0 Act of 2022 Signed into Law**

On December 29, 2022, President Biden signed into law the SECURE 2.0 Act of 2022 ("SECURE Act 2.0"). The SECURE Act 2.0 both builds on aspects of the 2019 SECURE Act and, like its predecessor, introduces new important changes to the retirement landscape.

Certain of the SECURE Act 2.0's provisions will have an immediate impact on tax-qualified retirement plans. The following is a summary of the key provisions in the SECURE Act 2.0, including effective dates applicable to each summarized provision.

REQUIRED MINIMUM DISTRIBUTIONS ("RMDS")

Increase in RMD Beginning Date: Currently, individuals are generally required to begin receiving RMDs from their tax-qualified retirement plans and traditional IRAs following the attainment of age 72 (Roth IRAs do not require RMDs during the life of the owner). The SECURE Act 2.0 increases the beginning age for mandatory distributions in two phases. Effective January 1, 2023, the beginning age for RMDs is increased to 73. However, this change has no effect on participants who attained the age of 72 in 2022 or earlier; such individuals must continue to take RMDs as scheduled. The main immediate effect will be on individuals who turn 72 in 2023, as such individuals will no longer be required to receive an RMD by April 1, 2024 (but will instead be required to receive their first RMD by April 1, 2025). The second phase of the change will take effect *a decade from now*, on January 1, 2033, when the beginning age for RMDs will be further increased to 75.

> *Effective Date:* Increase to age 73 was effective January 1, 2023; increase to age 75 will become effective on January 1, 2033.

Reduction in Excise Tax on Failure to Take RMD: Under current law, if an individual fails to receive an RMD, he or she must pay a steep penalty of 50% on the amount of the RMD not taken. The SECURE Act 2.0 reduces this penalty to 25%. Furthermore, the penalty is reduced to 10% if the individual receives a distribution of the RMD amount and submits an IRS excise tax return on Form 5329 in a timely manner (within 2 years or before receiving an assessment/notice of deficiency). In addition, individuals are still eligible to receive a complete waiver of the tax for reasonable cause.

> *Effective Date:* January 1, 2023.

CATCH-UP CONTRIBUTIONS AND ROTH 401(K) PROVISIONS

Enhanced Catch-Up Contributions for Participants Ages 60-63: Under current law, a 401(k) plan participant who has attained age 50 can make a $7,500 "catch-up" contribution each year in excess of the otherwise applicable contribution limits. This catch-up contribution limit is indexed for inflation.

---

* We gratefully acknowledge the assistance of our associate Ian David and our incoming associate Kaleb Mount in the preparation of this client alert.

For the year in which a participant attains age 60, the SECURE Act 2.0 increases the maximum catch-up contribution amount to the greater of (i) $10,000 or (ii) 150% of the of the "regular" $7,500 limit (as adjusted). Participants are eligible to make annual catch-up contributions at this enhanced level until the year in which they attain age 64. This new provision's $10,000 limit will be indexed for inflation for years beginning after December 31, 2025.

> *Effective Date*: Tax years beginning after December 31, 2024.

Certain Participants Must Make Catch-Up Contributions on an After-Tax Basis: Current law provides that a participant who is eligible to make catch-up contributions to a 401(k) plan may do so on either on a pre-tax or an after-tax Roth basis (if the plan offers a Roth option). Under the SECURE Act 2.0, if a participant's wages for the prior year from the employer who sponsors the plan exceeded $145,000, he or she may only make catch-up contributions in the current year on an after-tax "Roth" basis. For purposes of applying this limit, wages are determined in the same manner as for Social Security purposes. A participant whose wages from the sponsoring employer did not exceed $145,000 in the prior year may choose to make either pre-tax or after-tax Roth catch-up contributions in the current year. The $145,000 wage amount will be indexed for inflation beginning in 2025.

> *Effective Date*: Tax years beginning after December 31, 2023.
>
> Note: This new rule applies to all plans that offer catch-up contributions, including ones that do not currently have a Roth option for other contribution types. Accordingly, plans that do not offer Roth-designated accounts will need to accommodate this rule by allowing for Roth catch-ups or eliminating catch-up contributions entirely.

No Lifetime Required Minimum Distributions for Roth 401(k) Accounts: While the owner of a Roth IRA is not required to receive RMDs during his or her lifetime, a participant with a Roth-designated account in a 401(k) plan is required to receive pre-death distributions from such account in accordance with the Internal Revenue Code's RMD rules. The SECURE Act 2.0 puts Roth IRAs and Roth 401(k) accounts on equal footing in this regard by exempting Roth 401(k) accounts from these pre-death distribution requirements. Plan sponsors can choose to continue to require Roth 401(k) accounts to be paid by a certain age (such as the RMD age for non-Roth 401(k) accounts) if desired.

> *Effective Date*: Applies to distributions to be made after December 31, 2023, except for 2023 RMDs to be paid by April 1, 2024.

Option to Treat Employer Contributions as After-Tax Contributions: Employer matching contributions and other employer *(e.g.*, profit sharing) contributions (collectively, "Employer Contributions") to a 401(k) plan cannot be made on a Roth basis under current law. The SECURE Act 2.0 provides that a 401(k) plan may allow participants to designate all or a portion of any Employer Contributions as after-tax Roth contributions. Additionally, a participant must be fully vested in any Employer Contributions made on a Roth basis, and such amounts must be included in the participant's gross income. Because of this full-vesting requirement, amending a plan to allow an after-tax option for Employer Contributions could result in a significant extra cost to the plan sponsor if the normal pre-tax Employer Contributions are subject to a vesting schedule.

> *Effective Date*: Date of enactment.

401(K) PLAN OPERATIONAL MATTERS

Automatic Enrollment and Automatic Escalation for New Plans: Under current law, 401(k) plans are permitted to automatically enroll participants at a default contribution rate absent an affirmative election by the participant to the contrary. 401(k) plans can also increase this default contribution rate automatically following the participant's first year of participation, a practice known as automatic escalation. However, a participant's automatic contributions cannot exceed 15% of his or her compensation (or applicable IRS limits).

401(k) plans established after the SECURE Act 2.0's enactment are required to include these automatic-enrollment and automatic-escalation features. The plans must adopt an initial default contribution rate between 3% and 10% of compensation for all automatically enrolled participants. Additionally, automatically enrolled participants' default contribution rate must be increased by 1% per subsequent year of participation up to a fixed maximum rate between 10% and 15% of compensation (as set by the plan sponsor). Participants will have the option to elect out of automatic enrollment and automatic escalation. If an automatically enrolled participant does not make an election concerning the investment of these contributions, the contributions will be invested pursuant to the DOL's rules concerning qualified default investment alternatives.

Preexisting plans that were adopted by employers prior to the enactment of the SECURE Act 2.0 are grandfathered and not subject to these provisions. However, these mandatory automatic-enrollment and automatic-escalation rules will also apply to any employer who adopts a multiple employer plan after the SECURE Act 2.0's enactment (even though the multiple employer plan was already in existence prior to the enactment).

Effective Date: Plan years beginning after December 31, 2024.

Student Loan Payments Eligible for Matching Contributions: The SECURE Act 2.0 allows plans to treat participants' qualified student loan repayments for higher education as salary deferrals for purposes of the plans' matching contribution provisions. Employers would be allowed to rely on a participant's self-certification with respect to such student loan payments, and both a participant's qualified student loan repayments and other elective deferrals would count towards the Internal Revenue Code's applicable annual elective deferral contribution limits.

In order to implement this new rule, the plan must also offer matching contributions on traditional salary deferrals, and the new matching contributions on qualified student loan payments must be subject to the same eligibility, vesting, and matching percentage rules that apply to the matching contributions on traditional salary deferrals.

Effective Date: Plan years beginning after December 31, 2023.

Small Financial Incentives to Contribute to a 401(k) Plan: The SECURE Act 2.0 allows employers to offer small financial incentives, such as low-dollar gift cards, to help increase employee participation in 401(k) plans. The financial incentives may not be paid for with plan assets.

Effective Date: Plan years beginning after date of enactment.

Expanded Plan Participation for Part-Time Workers: The SECURE Act requires that long-term part-time workers be allowed to participate in the salary deferral portion of their employers' 401(k) plan if they have completed at least 500 hours of service for each of three consecutive 12-month periods. Service performed prior to 2021 is disregarded for plan eligibility purposes. The SECURE Act 2.0 modifies this rule by shortening the service requirement to two consecutive 12-month periods with at least 500 hours of service per year. With respect to employees impacted by this new provision, service performed prior to 2023 is disregarded for plan eligibility and vesting purposes. As was the case under the SECURE Act, employer contributions are not required with respect to employees who become eligible to participate in the plan solely due to these rules.

Effective Date: Plan years beginning after December 31, 2024.

Reliance on Employee Certification of Hardship: Under current law, while administrators of plans that offer hardship withdrawals may rely on a participant's certification that the participant has insufficient funds available to address a hardship, they generally must obtain documentation from the participant that substantiates the occurrence of the hardship event and the amount needed for the withdrawal. The SECURE Act 2.0 streamlines the hardship distribution process by allowing plan administrators to rely on a participant's certification both for the occurrence of the hardship event and the amount needed for the hardship withdrawal.

Effective Date: Plan years beginning after the date of enactment.

DISTRIBUTIONS

Increase in Cash-Out Limits: If a participant in a tax-qualified plan has a benefit with a value of less than $5,000, current law allows the employer to distribute the amounts without participant consent upon a termination of the participant's employment. The SECURE Act 2.0 increases the threshold for such mandatory distributions from $5,000 to $7,000 for distributions made after December 31, 2023.

Effective Date: December 31, 2023.

Recontribution of Birth/Adoption Distributions: The original SECURE Act allowed participants to take distributions up to $5,000 without paying a 10% early withdrawal penalty to pay qualified birth or adoption expenses. Participants were allowed to recontribute the amount of the distribution to the plan at any time, and the recontribution was treated as a rollover. The participant could then file an amended return to receive a refund of taxes paid in the year of the distribution, but if the amended return was filed more than three years after the distribution, the period of limitations for the return would be closed, precluding a refund. The SECURE Act

2.0 fixes this mismatch by limiting the allowable recontribution period to 3 years beginning on the day after the date on which the distribution was received.

> *Effective Date*: Immediately for distributions made after December 29, 2022; for distributions made prior to December 30, 2022, the repayment period is retroactively set to December 31, 2025.

Penalty-Free Withdrawals: Participants generally must pay a 10% early withdrawal penalty on distributions they receive before reaching the retirement age of 59½. While certain exceptions to the 10% penalty (such as disability) already exist under current law, the SECURE Act 2.0 provides the following additional exceptions to the penalty:

- *Domestic Abuse*: Participants who self-certify they have experienced domestic abuse within the previous 1-year period may withdraw up to the lesser of $10,000 or 50% of the participant's account without paying the early withdrawal penalty. The participant may repay the amount of the distribution to the plan within 3 years.

  Effective Date: Distributions made after December 31, 2023.

- *Terminal Illness*: Participants who are otherwise eligible for a distribution and who have been certified by a physician as having a terminal illness which can reasonably be expected to result in death in 84 months or less may receive such distribution without paying the early withdrawal penalty. There is no limit on the amount that may be withdrawn. The amount of the distribution can be repaid to the plan within 3 years.

  Effective Date: Distributions made after December 29, 2022.

- *Emergency Expenses*: Participants are allowed to receive one penalty-free "emergency personal expense distribution" of up to $1,000 per calendar year. Participants may self-certify that they need the funds "for purposes of meeting unforeseeable or immediate financial needs relating to necessary personal or family emergency expenses." The participant may repay the amount of the distribution to the plan within 3 years. In the 3 calendar years following an emergency personal expense distribution, the participant is not eligible to receive another such distribution unless he or she has repaid the amount of the previous distribution or has made employee 401(k) and/or after-tax contributions to the plan that equal or exceed the amount of the last emergency personal expense distribution.

  Effective Date: Distributions made after December 31, 2023.

OTHER NOTEWORTHY ITEMS

Emergency Savings Accounts: In order to help individuals meet unexpected financial obligations without taking money out of their retirement savings, the SECURE Act 2.0 allows an employer to amend its individual account retirement plan to offer "pension-linked" emergency savings accounts ("ESAs") to non-highly compensated participants. A participant's contributions to his or her ESA must be made on an after-tax basis, and the portion of the ESA's account balance attributable to participant contributions may not exceed $2,500 (indexed for inflation), though employers may establish a lower limit. Additionally, a participant's ESA contributions must be taken into account for purposes of calculating any employer matching contribution under the plan for 401(k) contributions, though such matching contributions may not be made to the ESA.

A participant (a) must be eligible to receive a distribution from his or her ESA at least once per month and (b) may make up to four ESA withdrawals in a given plan year before incurring any processing fees or other charges on account of such withdrawals. Unlike traditional hardship withdrawals, withdrawals from an ESA may be made at the participant's discretion. Funds contributed to an ESA must be invested in cash, an interest-bearing account, or a fund designed to preserve principal. Earnings (if any) on ESA contributions are generally not included in the participant's taxable income when he or she receives a distribution from an ESA.

> *Effective Date*: Plan years beginning after December 31, 2023.

Enhancements to the IRS's Self-Correction Program for Certain Plan Failures: The IRS's Employee Plans Compliance Resolution System ("EPCRS") encourages plan sponsors and employers to correct operational shortcomings arising from the plan's failure to follow applicable governance documents and/or Internal Revenue Code provisions. By following the EPCRS's protocols, plan sponsors and employers can prevent the plan from inadvertently losing its tax-qualified status.

Prior to the SECURE Act 2.0, while self-correction was broadly available for operational errors corrected within 3 years, once the 3-year limit was reached, self-correction was available only for a relatively narrow range of minor operational errors. The SECURE Act 2.0 expands the scope of the EPCRS's self-corrections program, thus giving plan sponsors more flexibility to correct a variety of operational shortcomings beyond the 3-year period. (There are still limits on the use of the self-correction program, particularly if the issue is identified by the IRS before the plan sponsor’s correction process begins or if the plan sponsor does not correct the issue within a reasonable period of time after discovery.)

In addition, the SECURE Act 2.0 allows for the self-correction of all "eligible inadvertent failures" related to plan loan errors, whereas certain types of plan loan failures were not eligible for self-correction under prior guidance. If plan loan errors due to inadvertent mistakes are self-corrected under the EPCRS's procedures, such corrections will be deemed to have satisfied the requirements of the DOL's Voluntary Fiduciary Correction Program ("VFCP") (though additional procedural steps may be necessary to demonstrate such correction to the DOL).

Furthermore, while self-correction was previously limited to tax-qualified employer plans (and certain other similar arrangements), the SECURE Act 2.0 now permits IRA custodians to self-correct certain inadvertent IRA operational errors under the EPCRS.

> *Effective Date*: Date of enactment.
>
> Note: Because self-correction does not involve a formal submission to the IRS and a plan may still be audited for an issue that was self-corrected, it is incumbent on plan fiduciaries to keep accurate records of such actions.

Increased Flexibility for Plan Fiduciaries Regarding Overpayments: Under current law, fiduciaries are generally required to take reasonable steps to recover inadvertent overpayments (*e.g.*, excess payments due to benefit miscalculations) made by a retirement plan to participants or their beneficiaries (although certain exceptions to full correction currently apply). Failure to follow applicable procedures for recovering overpayments could result in a violation of ERISA and/or jeopardize the plan's tax-qualified status.

The SECURE Act 2.0 grants fiduciaries additional flexibility with respect to whether or not to recover "inadvertent benefit overpayments" from participants, beneficiaries or other parties (such as service providers responsible for the overpayment). The new law further clarifies that failure to recover such overpayments will not necessarily jeopardize the plan's tax status or constitute a violation of ERISA.

If a plan fiduciary does decide to recover an inadvertent overpayment from a participant, the SECURE Act 2.0 imposes guardrails intended to protect the payment recipient. For example, there are caps on the ability to reduce any future monthly payments to recover the overpayment, and the plan cannot charge interest on the overpayment amount or engage a collection agency to recoup the overpayment. Additionally, recoupment may not be sought if the overpayment occurred more than three years before the participant is first notified in writing of the error. Recoupment of a participant’s overpayment may not be sought against a spouse or other beneficiary.

Prior to enactment of the SECURE Act 2.0, if a participant received an overpayment and rolled that payment over into either an IRA or another tax qualified plan, that rollover contribution was retroactively invalid. As a result, the participant would be obligated to reverse the rollover contribution, which could trigger additional tax on the overpayment amount. The SECURE Act 2.0 provides that such rollover contributions will not be invalidated or subject to additional adverse tax consequences.

> *Effective Date*: Date of enactment (and employers are generally able to rely on good faith actions and determinations made prior to the date of enactment)
>
> Note: The decision by a fiduciary not to pursue an overpayment does not relieve a defined benefit plan sponsor of any obligations with respect to minimum plan funding, if applicable. Additionally, the participant protections discussed above do not apply if the participant or beneficiary bears responsibility for the overpayment or knew (or should have known) that the amount received from the plan was materially in excess of the correct amount.

New Timing for Amendments Increasing Benefits: Current law provides that discretionary amendments which retroactively provide for benefit increases under a tax-qualified plan must be made by the end of the plan year in which the amendment took effect. The SECURE

Act 2.0 extends the deadline for plans to make such amendments. Specifically, a retroactive amendment regarding a discretionary benefit increase may be made until the filing deadline, including extensions, for the employer's income tax return for the year in which the benefit increase was implemented.

> *Effective Date*: Plan years beginning after December 31, 2023.
>
> Note: This new timeframe for amendments related to benefit increases does not apply to amendments concerning employer matching contributions.

PLAN AMENDMENT DEADLINE

Plans will need to be formally amended to reflect the requirements of the SECURE Act 2.0. The deadline for such amendments is the last day of the first plan year beginning on or after January 1, 2025 (2027 for collectively bargained and governmental plans). However, as many SECURE Act 2.0 provisions are effective immediately, plans must be operated in accordance with the new law before the amendment deadline.

Next Steps

The SECURE Act 2.0 contains many changes to the retirement landscape, some of which immediately impact the administration of retirement plans. You should review the new changes and consult your retirement and tax advisors to discuss implementing the SECURE Act 2.0, including the required and optional operational changes, plan amendments, and participant communications.

This update is not intended to provide legal advice with respect to any particular situation, and no legal or business decision should be based solely on its content.

If you have any questions about this update, please contact:

Norman J. Misher	212-903-8733	nmisher@rhtax.com
Allen J. Erreich	212-903-8769	aerreich@rhtax.com
Judy M. Hensley	212-903-8737	jhensley@rhtax.com
Chase B. Steinlauf	212-903-8736	csteinlauf@rhtax.com
Emily L. Gulyako	212-903-8752	egulyako@rhtax.com

The **Employee Benefits and Executive Compensation Group of Roberts & Holland LLP** concentrates on a wide variety of employee benefits and executive compensation matters in both the transactional and compliance contexts. We focus on tax, ERISA and other legal considerations relating to all aspects of employee benefit plans, programs and arrangements, including design, administration and compliance of tax-qualified plans and ERISA fiduciary matters for investment funds and plan fiduciaries. We also regularly represent clients in designing, negotiating and drafting equity compensation arrangements and nonqualified deferred compensation plans, as well as executive employment, severance and change-in-control agreements and provide advice on the associated ERISA and tax implications.