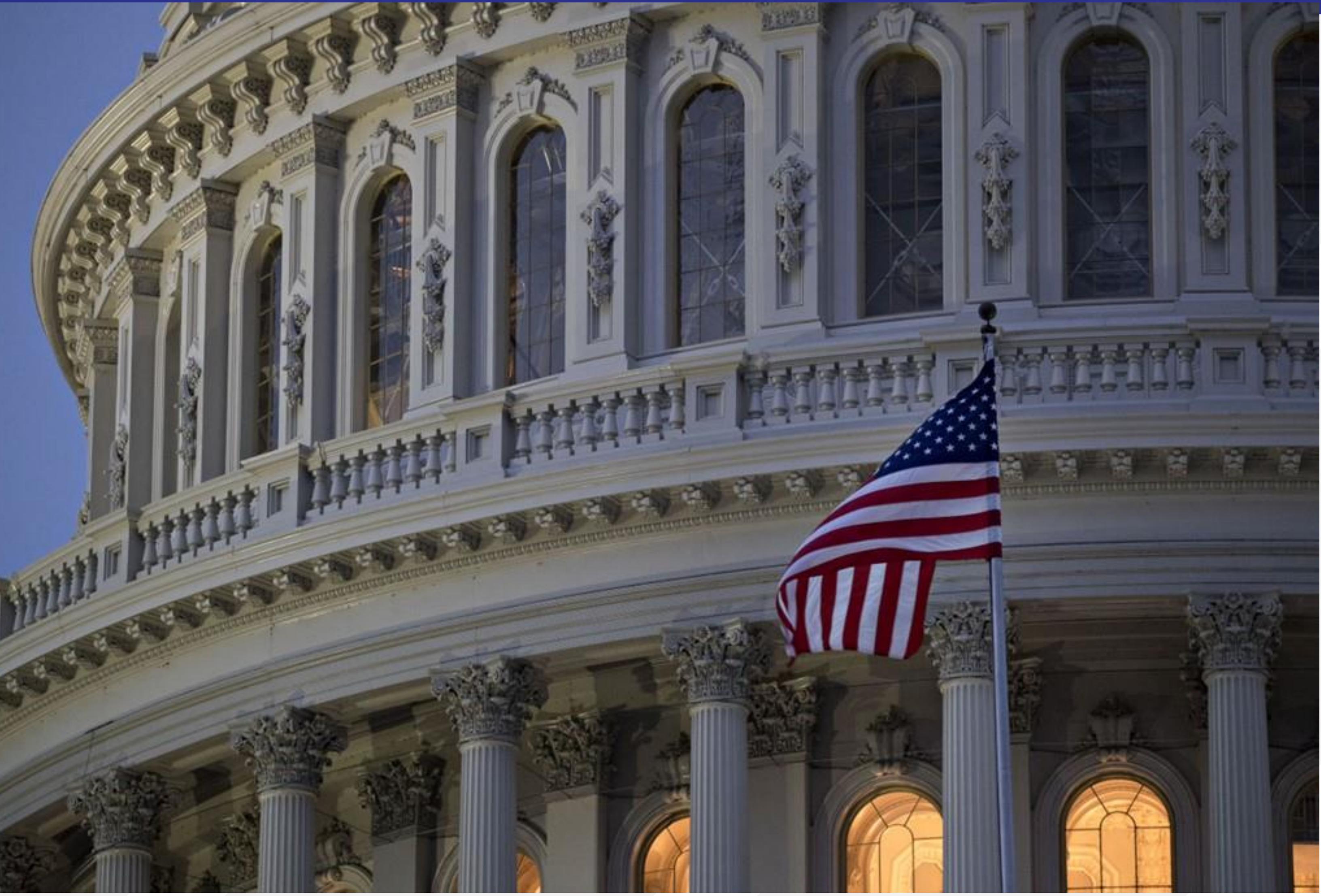
SECURE 2.0 Act Provisions and Their Continued Impact



PENTEGRA

Since the SECURE 2.0 Act ("SECURE 2.0") was enacted in late 2022, it has occupied an outsized place in the retirement plan industry.

SECURE 2.0 Act has nearly 100 provisions—with different effective dates—contain numerous benefits for employers, participants, advisors, and others. But we've also had to face multiple challenges surrounding effectively implementing many of them. The IRS has released guidance in Notice 2024-2, but we need much more direction on many other provisions. Still, there is cause for optimism. New provisions became effective in 2024. And we may be getting closer to taking advantage of other features that have resisted implementation for lack of previous guidance.

Significant SECURE 2.0 Act Provisions Effective in 2024

Dozens of SECURE 2.0 provisions became effective either immediately or in 2023. Others will become effective in 2025 or later. But for 2024, nearly 20 new provisions are now in place. Here are some of the more significant ones.

Two Exceptions to the 10% Early Distribution Penalty

Generally, plan participants and IRA owners are subject to a 10% additional tax (penalty) for distributions taken before age 59½. There are, however, numerous exceptions aimed at lessening the tax burden for those who take early distributions for approved reasons. Many of these exceptions are optional, so employers may decide not to allow such withdrawals.

Emergency expense – This optional provision allows participants (and IRA owners) to withdraw up to $1,000 per year to meet an "emergency," which is, as of yet, undefined by the IRS. The SECURE 2.0 text states that such distributions must be "for purposes of meeting unforeseeable or immediate financial needs relating to necessary personal or family emergency expenses." Employers may rely on a participant's self-certification that they meet this presumably broad definition unless they have actual knowledge to the contrary. Emergency expense distributions may be repaid within three years under rules similar to those that apply to repayments for qualified birth or adoption distributions (QBADs). And no further emergency expense distributions are permitted within three years unless the previous distribution is fully repaid (or until the recipient defers at least the unpaid amount back into the plan).

Victims of domestic abuse – Employers may allow participants to withdraw one-half of their vested account balance (up to $10,000) per incident of domestic abuse of the participant, the victim's child, or another family member living in the household. Participants may self-certify and may pay back the distribution under rules that are similar to the repayment rules for QBADs.

Employers May Match Certain Student Loan Payments

Congress didn't want recent college or trade-school graduates with limited resources to have to choose between paying student loans and deferring some of their income into a workplace retirement plan. So, starting in 2024, employers may provide matching contributions based on qualified student loan payments. For employers who adopt this provision, certain other rules apply. For example, matching contributions on student loan payments must be made at the same rate as matching contributions made on actual deferrals. Participants may self-certify each year that they have made qualifying student loan payments as well as indicating the repayment amount. This optional provision also applies to SIMPLE IRA plans.

RMDs No Longer Required from Designated Roth Accounts

With Roth IRAs, required minimum distributions (RMDs) have never been required during the Roth IRA owner's lifetime. But until SECURE 2.0, designated Roth accounts in employer-sponsored plans had to be included in the account assets that were subject to RMDs. Now, Roth account rules for RMDs mirror the Roth IRA rules: for distributions required after December 31, 2023, these assets are carved out of the annual account balance that is used to determine RMDs for those participants who have reached the point at which they must take distributions each year. This change may require some additional programming or manual work for recordkeepers and third-party administration firms. It also removes one advantage of rolling over Roth employer-plan assets into a Roth IRA.

Correcting Auto-Contribution Errors (Making a Permanent Fix)

SECURE 2.0 makes permanent a provision that allows plan sponsors to correct certain errors that relate to automatic-enrollment and auto-escalation features. Previous relief expired at the end of 2023. Briefly, this guidance includes a safe harbor that allows for a less burdensome correction if a notice is given to the affected employee, if correct deferrals commence within certain prescribed periods, and if the plan sponsor makes any matching contributions that would have been made had the failure not occurred. Automatic-enrollment (and escalation) plans have proven to make a big difference with participation and savings rates. But plan sponsors can still make mistakes. This permanent opportunity to fix mistakes may help make such features even more attractive. And remember that automatic enrollment will be required for certain plans starting in 2025.

SECURE 2.0 contains numerous beneficial provisions for plan sponsors and participants alike.

SIMPLE IRA Plans May Be Amended Mid-Year to a Safe Harbor 401(k) Plan

Employers with SIMPLE IRA plans may see an advantage in adopting an ADP/ACP safe harbor 401(k) plan. For example, a safe harbor 401(k) plan will allow the employer to defer substantially more, while also requiring a slightly higher employer matching or nonelective contribution. SIMPLE IRA plans generally cannot make mid-year changes. But now employers can "upgrade" to a safe harbor 401(k) plan, but keep in mind that certain regulatory limits may need to be prorated based on the portion of the year each plan was in place.

Pension-Linked Emergency Savings Accounts Allowed

To further address the lack of emergency savings that many individuals experience, SECURE 2.0 permits employers to create a "pension-linked emergency savings account," or PLESA, that participants can easily access without any penalty. Some detailed requirements apply, so employers and service providers may not be all that eager to adopt this provision. For example, the account is capped at $2,500, contributions are made as Roth elective deferrals, automatic enrollment (up to three percent of an employee's compensation) is permitted, and the first four distributions each year must be free from service fees. Further guidance from the IRS may help make this provision more likely to be embraced by the industry.

Long-Term, Part-Time Employees May Be Eligible for Deferrals in 2024

Although any employees who may be eligible for plan participation under SECURE 2.0's long-term, part-time (LTPT) provisions will not be eligible until 2025, certain LTPT employees may be eligible under SECURE 1.0's parallel provision in 2024. Briefly and at a high level, SECURE 1.0 requires employers to allow salary deferrals for individuals who worked at least 500 hours in three previous consecutive years. Employers had to start counting these hours in the 2021 tax year, so the first year to include such affected employees is 2024. SECURE 2.0 reduced the three-year rule to two years but counting for the new rule started in 2023. As a result, the new two-year rule may require employers to allow deferrals in 2025. No employer matching or profit-sharing contributions are required under this provision.

Miscellaneous Provisions Effective for 2024

Several other SECURE 2.0 Act provisions became effective this year. Additional IRS guidance on these (and many other items) may provide clarity on their implementation.

- ***Increased cash-out limit –*** Employers who do not receive direction from former employees about how to distribute their accounts may pay the assets directly to an IRA established for the former employee. The previous cash-out limit was $5,000. Now, accounts that do not exceed $7,000 may be cashed out.
- ***"Starter 401(k)" plans now available –*** Employers currently without a retirement plan may adopt a deferral-only 401(k) (or 403(b)) plan that automatically enrolls participants with deferrals from 3 – 15 percent of their compensation. Contributions are subject to a much lower limit than traditional 401(k) plans, so interest in these plans may be minimal.
- ***Employers may provide extra benefits retroactively –*** SECURE 2.0 extends the deadline by which retroactive amendments may increase plan benefits in certain circumstances for stock bonus, pension, profit-sharing, or annuity plans. If the plan is amended by the employer's tax return due date (plus extensions), the amendment will be treated as if it had been made by the last day of the previous plan year.

- ***403(b) hardship rules align with 401(k) rules –*** Hardship distribution rules for 401(k) and 403(b) plans were different enough to create unnecessary confusion. For example, earnings from certain 403(b) assets were not available for hardship withdrawals. Now, 403(b) hardship rules conform with the 401(k) rules.

IRS Notice 2024-2 Provides (Some) Helpful Guidance

On December 20, 2023, the IRS released Notice 2024-2, Miscellaneous Changes Under the SECURE 2.0 Act of 2022. This "grab bag notice" provides guidance on several SECURE 2.0 provisions but leaves others unaddressed. The IRS acknowledges that this notice is intended to provide interim guidance—and not comprehensive guidance—on particular issues to help retirement plan providers, employers, and individual taxpayers implement certain SECURE 2.0 Act provisions. Here are some of the items that the notice addressed.

Automatic Enrollment

This provision will require many plans to contain an auto-enrollment feature by the 2025 plan year. Some exceptions apply: plans that were established before December 29, 2022, small employer plans (with 10 or fewer employees), and businesses less than three years old are not required to adopt auto enrollment.

Notice 2024-2 clarifies that a plan that was initially adopted before December 29, 2022, is grandfathered, even if the effective date was January 1, 2023. Most of the other Q&As in the notice address plans that are either merged or spun off when one plan was a "pre-enactment qualified CODA" and the other was not. These situations do not arise for most clients, but the guidance in the notice may be helpful when such facts present themselves. More importantly, employers whose plans are not exempt from this requirement should prepare to implement auto-enrollment for the 2025 plan year. And those adopting new plans this year should consider establishing their plan with an auto-enrollment feature rather than having to amend for this in 2025.

Start-up Credit and Contribution Credit

As a reminder, the new plan start-up credit has been increased to 100 percent of start-up costs (from 50 percent) for employers with no more than 50 employees. This credit applies for the first three years that the plan is in place. SECURE 2.0 added a new credit for employer contributions. The credit applies to contributions made to employees who make no more than $100,000 per year, and is limited to $1,000 per employee. The credit is 100 percent for the first two years, 75 percent for the third year, 50 percent for the fourth year, and 25 percent for the fifth year. The credit is gradually phased out for employers with more than 50 employees.

The Q&As clarify that an employer can qualify for both credits at the same time. The plan is treated as being established on the date that the plan becomes effective. But the employer can elect for the "first start-up costs credits year" to be the taxable year preceding the taxable year in which the plan becomes effective. This makes sense because the most significant costs of a new plan could be incurred before the plan becomes effective. The notice also clarifies that a contribution made for a previous plan year—but in the following year—is eligible for the credit for the year for which the contribution was made.

Matching and Non-elective Contributions as Roth Contributions

This provision allows plan participants to elect to have employer matching and non-elective contributions be made as "designated Roth contributions." These contributions are included in gross income and are non-forfeitable at the time they are received. Although such contributions were available as of SECURE 2.0's enactment date, this provision has seen limited utilization because of the lack of IRS guidance.

Notice 2024-2 clarifies that the rules for the new designated Roth matching contributions and designated Roth non-elective contributions are like the existing rules for designated Roth elective deferrals:

- Employees must designate matching or non-elective contributions as a Roth contribution before the contribution is allocated to the employee's account—and the election must be irrevocable (with respect to those contributions).
- Designated Roth matching and non-elective contributions must be included in the employee's income and must be separately accounted for (as with all Roth contributions). These contributions are included in the employee's gross income for the taxable year in which they are allocated to the employee's account, even if the employer deems them to have been deductible for the prior taxable year.
- Employees must have an "effective opportunity" to make or change the designation at least once during each plan year.

Perhaps the most significant piece of guidance in this section resolves the concern about Roth matching and non-elective contributions being fully vested when contributed. The IRS takes a simple, workable approach: employees cannot designate a matching or non-elective contribution as a Roth contribution unless they are fully vested in that type of contribution at the time the contribution is allocated.

Other SECURE 2.0 Act Provisions Addressed

Much of Notice 2024-2 merely clarifies the IRS's position on various provisions. As is often true with significant legislative change, additional direction from the IRS is needed. And because the regulatory process can take many months (or years), we expect the IRS to continue to release notices (or other sub-regulatory guidance) even as it works on creating more permanent regulations. Notice 2024-2 also clarified the IRS's stance on several other SECURE 2.0 Act provisions.

- Military spouse credit
- Increased contributions for SIMPLE plans
- Terminal illness exception to the 10% early distribution penalty
- Mid-year SIMPLE plan amendment to an ADP/ACP safe harbor 401(k) plan
- Cash balance plan calculations for greater funding flexibility
- Plan amendments pushed back to 2026 for most plans
- SEP and SIMPLE plan Roth contributions

Closing Thoughts

Some—like the start-up and contribution credits provide an excellent way for advisors to help employers to adopt retirement plans with nearly no out-of-pocket costs. But like most new provisions, the details matter. So those taking advantage of the many provisions now available should approach this endeavor with care. While some SECURE 2.0 items are straightforward, others have more moving parts that can complicate the process.

Employers should also take great care in documenting any SECURE 2.0 provision that they adopt. Because plan amendments for SECURE 2.0 will not be required (in most cases) until the end of the 2026 plan year, employers should meticulously track which optional provisions have been adopted—and when. This will make it much easier to correctly create the plan amendment when it is required several years from now.

For more guidance on SECURE 2.0 Act, contact the Pentegra Solutions Center at solutions@pentegra.com or 855-549-6689 or visit Pentegra's SECURE 2.0 Act resource page.

PENTEGRA