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Skadden

Executive Compensation and Benefits Alert

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$1.7 Trillion Spending Package Includes Significant Changes to Retirement Plans

On December 29, 2022, President Joe Biden signed into law the Consolidated Appropriations Act of 2023, which includes the SECURE 2.0 Act of 2022 (SECURE 2.0). SECURE 2.0 is an expansion of the Setting Every Community Up for Retirement Enhancement Act of 2019 (the SECURE Act). SECURE 2.0 includes over 90 retirement plan provisions, many of which build on and expand the retirement plan enhancements contained in the SECURE Act.

Select Summary of Key Changes

The following is a summary of some of the key retirement plan enhancements in SECURE 2.0 that will directly impact most tax-qualified defined contribution retirement plans.

Effective Immediately:

- **Changes to required minimum distribution (RMD) requirements.** The SECURE Act increased the age that retirement plan participants are required to begin receiving required minimum distributions (RMDs) from age 70 1/2 to 72. SECURE 2.0 further increases the age to receive RMDs to age 73 after December 31, 2022 (and to age 75 after December 31, 2032). SECURE 2.0 also modifies how RMDs are calculated with respect to annuity payments and decreases the excise tax for a failure to take RMDs from 50% to 25% of the missed RMD (or 10% if the missed RMD is timely corrected).
- **Hardship distribution rules.** Effective for plan years beginning after the date of enactment, plan sponsors may rely on an employee's self-certification that the employee has experienced a deemed hardship for purposes of taking a hardship withdrawal and that the distribution is not in excess of the amount required to satisfy the financial need.
- **Waiver of early withdrawal penalties for certain distributions.** The 10% penalty on early withdrawals before age 59 1/2 is waived for distributions to individuals whose physician certifies that they have an illness or condition that is reasonably expected to result in death within 84 months.
- **Employer contributions designated as Roth contributions.** Employers may allow plan participants to designate employer matching and nonelective contributions as after-tax Roth contributions, which would require that such contribution be included in the participant's income for the year made. Employer contributions designated as Roth contributions must be immediately 100% vested.

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- **Incentives for plan participation.** Effective for plan years beginning after the date of enactment, as an exception to the 401(k) plan "contingent benefit rule" (which generally prohibits conditioning employer-provided benefits on whether an employee makes elective contributions under the 401(k) plan), employers are permitted to provide de minimis financial benefits, such as gift cards, as an incentive for employees to elect to contribute to a 401(k) plan, provided that such incentives are not funded with plan assets.
- **Employee Plans Compliance Resolution System (EPCRS).** SECURE 2.0 provides various enhancements to the EPCRS, including expansion of the operational errors eligible for self-correction to include all such errors, including significant errors, provided that the error is corrected within a reasonable time after it is discovered and the Internal Revenue Service has not identified the error prior to the commencement of the self-correction. In addition, the requirement for plan sponsors to attempt to recoup certain inadvertent overpayments from distributees is eliminated.

Effective Beginning in 2024:

- **Student loan repayments matching contributions.** Effective for plan years beginning after December 31, 2023, subject to certain requirements and limitations, employers may make matching contributions to a defined contribution plan by treating an employee's qualified student loan payments as employee contributions entitled to a matching contribution from the employer.
- **Mandatory distributions.** The involuntary cash-out limit (the threshold balance below which an employer may force a distribution of smaller account balances without employee consent) is increased from $5,000 to $7,000.
- **Emergency savings accounts.** Effective for plan years beginning after December 31, 2023, employers may amend their individual account defined contribution plans to offer short-term emergency savings accounts, which would be funded with after-tax Roth contributions up to a maximum of $2,500 (indexed for inflation), from which participants must be allowed to take up to one withdrawal per month.
- **Catch-up contributions for participants earning more than $145,000.** Catch-up contributions for participants who earned more than $145,000 in the prior year (indexed for inflation) must be made on a Roth after-tax basis.
- **Waiver of early withdrawal penalties for certain distributions.** The 10% penalty on early withdrawals before age 59½ is waived for certain distributions, including (i) up to $1,000 per year for certain unforeseen personal or family emergency expenses, and (ii) up to the lesser of $10,000 (indexed for inflation) and 50% of the participant's vested account balance for distributions in connection with domestic abuse.

Effective Beginning in 2025:

- **Automatic enrollment.** New 401(k) and 403(b) plans adopted after December 31, 2024, must provide for (subject to various requirements including an employee opt-out) automatic contributions between 3% and 10% of compensation, with automatic escalations of at least 1% per year up to a deferral rate of no less than 10% but not more than 15%.
- **Increase to catch-up contribution limits.** Effective for taxable years beginning after December 31, 2024, the catch-up contribution limits for participants who are age 60 to 63 will increase to the greater of (i) $10,000 or (ii) 150% of the regular catch-up contribution limit for 2024, indexed for inflation.
- **Coverage of long-term part-time employees.** Under the SECURE Act, part-time employees who work at least 500 hours per year for at least three consecutive years, and who have reached age 21 as of the end of the three-year period, must be allowed to enroll and make elective deferrals under the employer's 401(k) plan at the end of such three-year period. Effective for plan years beginning after December 31, 2024, SECURE 2.0 reduces such three-year period to two years.

Next Steps

While many of the retirement plan provisions in SECURE 2.0 are not effective until later years, a number of important provisions are effective immediately and therefore require immediate attention. Accordingly, companies should speak with their retirement plan providers, plan administrators and plan counsel to discuss the impact of SECURE 2.0 on their tax-qualified retirement plans and coordinate next steps for implementation.

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