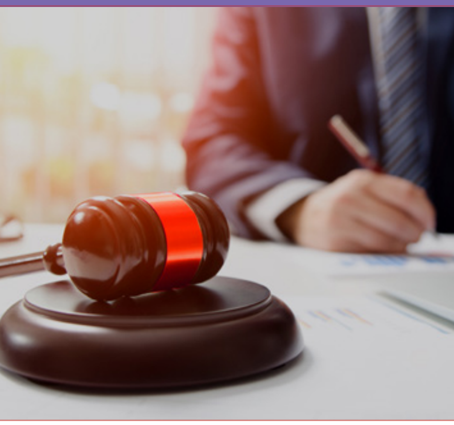
Eye on Washington

Legislative Update



SECURE 2.0 Act of 2022 Makes Sweeping Changes to Retirement Savings Plans

On December 29, 2022, the Consolidated Appropriations Act of 2023 (HR 2617) was signed into law. The Act includes important provisions affecting retirement savings plans which are intended to build upon the 2019 SECURE Act. These provisions, collectively referred to as SECURE 2.0, offer many new benefits to employers and employees which are designed to make it more attractive for employers to offer retirement plans and to improve retirement outcomes for employees.

Below is a summary of selected provisions with potentially broad effect. However, the Act includes some 90 provisions affecting retirement savings plans. Employers will need to consult with appropriate legal counsel and other professionals to assess what changes may be relevant to their circumstances.

Automatic Enrollment

Employers who start new retirement plans after December 29, 2022 will, beginning in 2025, be required to automatically enroll employees in their retirement plan at a rate of at least three percent, but not more than 10 percent of eligible wages. Employees may opt out. New companies (in business for less than three years) and employers with 10 or fewer workers are excluded from this requirement.

An Automatic Enrollment plan must allow employees to withdraw automatic contributions and any earnings within no more than 90 days of the first contribution without being subject to the 10 percent penalty on early withdrawals.

Automatic Escalation

Beginning in 2025, for new retirement plans started after December 29, 2022, contribution percentages must automatically increase by one percent on the first day of each plan year following completion of a year of service until the contribution is at least 10 percent, but no more than 15 percent of eligible wages. Exceptions apply for governmental and church plans, businesses with 10 or fewer employees, and employers that have been in business for less than three years.

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Catch-Up Contributions Increased; Must be Made on a Post-Tax ("Roth") Basis

In 2023, participants age 50 and older can contribute an extra $7,500 per year annually into their 401(k) account. This amount will increase to $10,000 per year (indexed for inflation) starting in 2025 for participants age 60 to 63. Also, after 2023, all catch-up contributions for participants earning over $145,000 annually must be made on a Roth (after-tax) basis.

Optional Roth Treatment of Employer Contributions.

Effective immediately, employers may amend their plans to permit employees to elect that employer matching and non-elective contributions be made as Roth (after-tax) contributions, as long as they are 100 percent vested when contributed to the plan. Additional guidance is expected.

Expanded Eligibility for Long-Term, Part-Time Employees

Currently, employees who work between 500 and 999 hours for three consecutive years must be allowed to participate in their company's retirement plan. SECURE 2.0 reduces the time period to two years, effective in 2025. This does not apply to employees who participate in collectively bargained plans, or to nonresident aliens.

Treatment of Student Loan Payments for Matching Contributions

Beginning in 2024, student loan payments can be treated as retirement contributions for the purpose of qualifying for matching contributions in a workplace retirement account. Employers will be able to make contributions to their company retirement plan on behalf of employees who are paying student loans instead of saving for retirement. Employers may rely on the employee to certify annually as to the amount of their qualifying student loan payments.

Emergency Savings Accounts Linked to Retirement Plans

Beginning in 2024, retirement plans may offer linked "emergency savings accounts" that permit non-highly compensated employees to make Roth (after-tax) contributions to a savings account within the retirement plan. Balances in an emergency savings account must be eligible for distribution at least once per month. Withdrawal transactions are penalty-free and do not need to be substantiated, e.g., to show a qualifying emergency cause.

Employers may automatically opt employees into these accounts at no more than three percent of eligible wages. Employees can opt-out of participation. No further contributions can be made if the savings account has reached $2,500 (indexed), or a lesser limit established by the employer. Once the cap is reached, additional contributions can be directed to the employee's Roth defined contribution plan (if they have one) or stopped until the balance falls below the limit. No employer contributions are permitted.

Employee contributions to an emergency savings account must be eligible for the same matching contributions that apply for elective deferrals. Matching contributions are made to the retirement plan – not to the emergency savings account. Upon termination of employment, any emergency savings account can be converted to another Roth account within the plan or can be distributed to the participant.

This provision addresses a common objection to participation in retirement savings. For instance, if an employee fears that they may need any retirement contributions for unforeseen emergencies. The Department of Labor and/or the Treasury Department may issue guidance on these provisions.

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Withdrawals for Certain Emergency Expenses

Generally, an additional 10 percent tax applies to early distributions from tax-preferred retirement accounts, such as 401(k) plans. In addition to the emergency savings account option described above, beginning in 2024, the Act provides an exception for certain distributions for emergency expenses, which are generally unforeseen immediate financial needs relating to personal or family emergency expenses. Only one distribution is permissible per year of up to $1,000, and a taxpayer has the option to repay the distribution within three years. No further emergency distributions may be made during the three-year repayment period until any amounts previously taken are repaid. The employer may rely on an employee's written certification that the employee is facing a qualifying emergency personal expense, absent actual knowledge to the contrary. Further guidance is expected on this provision.

Saver's Match

Beginning in 2027, lower-income employees will be eligible to receive a federal matching contribution of up to $2,000 per year that would be deposited into their retirement savings account. The matching contribution is 50 percent of the employee's contributions, but is phased out as income increases (for example, between $41,000 and $71,000 for married, filing jointly; $20,500 to $35,500 for single taxpayers, etc.). This match replaces the current Saver's Credit.

Required Minimum Distributions (RMDs)

The requirement to begin taking RMDs will increase from age 72 to age 73 in 2023, and then to age 75 in 2033. In addition, the penalty for not taking a RMD is reduced from 50 percent of the amount required to be withdrawn currently to 25 percent, and to 10 percent if corrected within two years.

Immediate Incentives for Participation

Currently, employers can only provide matching contributions as an incentive to participate in a retirement savings plan. Effective for plan years beginning after 2022, employers may offer modest financial incentives, such as gift cards, which may help increase participation. However, any financial incentives should be of de minimis amounts and cannot be paid with plan assets.

Expanded Credit for Retirement Plan Administrative Costs

Currently, employers with less than 100 employees may be eligible for a three-year start-up tax credit of up to 50 percent of administrative costs, with an annual limit of $5,000. SECURE 2.0 increases this credit to 100 percent of qualified start-up costs for employers with up to 50 employees. An additional credit of up to $1,000 per employee for eligible employer contributions may apply to employers with up to 50 employees, but phases out from 51 to 100 employees.

Retirement Savings "Lost and Found"

The Act establishes an online searchable database, within two years of enactment, that will allow a participant or beneficiary to search for contact information for plan administrators of plans in which the participant or beneficiary may have a benefit. Beginning in 2025, plans will be required to share information with the Department of Labor to be included in the database.

Facilitation of Error Corrections

The Act expands the self-correction system known as the Employee Plans Compliance Resolution System ("EPCRS") to allow more types of errors to be corrected internally and to exempt certain failures to make required minimum distributions from the excise tax. There are also new rules for correcting overpayments. These enhancements are effective upon enactment.

Next Steps

Further analysis may be necessary. Again, the **SECURE 2.0 Act** contains some 90 changes to retirement savings plans which should be reviewed in depth for applicability. Some provisions may require amendments to existing retirement plans and offerings. Employers should consult with appropriate legal counsel and financial professionals to identify any changes that must be made and determine what optional provisions may be beneficial.

ADP Compliance Resources

ADP maintains a staff of dedicated professionals who carefully monitor federal and state legislative and regulatory measures affecting employment-related human resource, payroll, tax and benefits administration, and help ensure that ADP systems are updated as relevant laws evolve. For the latest on how federal and state tax law changes may impact your business, visit the ADP *Eye on Washington* Web page located at **www.adp.com/regulatorynews**.

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Updated on January 5, 2023