

Congress passes SECURE 2.0 Act, making important changes to 401(k)s

The last act of the 117th Congress was to pass the [Consolidated Appropriations Act, 2023](#). Tucked not-so-deep into the CAA is the [SECURE 2.0 Act of 2022](#)—90+ provisions focused on 401(k) and other retirement plans. SECURE 2.0 builds on what we can now call SECURE 1.0, which was enacted in 2019.

SECURE 2.0 is an expensive piece of legislation. Congress has chosen to pay for it by mandating that plans offering certain 401(k) features, like catch-up contributions, be made on an after-tax, Roth basis.

Every mention of the word “Roth” will require significant adjustments to your payroll system to accommodate after-tax withholding. At a minimum, Payroll, HR and Benefits will need to work together to ensure the following:

- All eligible participants are timely enrolled into an auto-enrollment plan, and the proper amount is withheld and invested prudently, if employees don't indicate their investment choices
- All qualified part-time employees are enrolled in the plan and pretax deductions are made from their pay
- Determining employees' wages for catch-up contribution purposes.

Expanding coverage

The basis for withholding, including for auto-enrollment 401(k) plans, is that you can't miss what you never thought you had. Instead of opting in, employees must opt-out to receive their full pay. And most employees don't opt out.

Auto-enrollment plans

Auto-enrollment plans have been around for quite some time; SECURE 1.0 allowed but didn't require plans to auto-enroll new participants.

401(k) plans established after Dec. 29, 2022, must auto-enroll participants once they're eligible, beginning with the 2025 plan year. Employees are eligible to participate if they work full time, have completed 12 months of service, and are age 21 or older. The initial withholding percentages range from 3% to 10%, with automatic annual increases of 1% per plan year, up to 10%, but not more than 15%. Employees can elect a lower percentage.

Employers in business for fewer than three years, small employers with up to 10 employees, church plans, and governmental plans are excluded from these provisions.

SECURE 2.0 also introduces a new safe harbor 401(k) plan design—a starter 401(k) plan, effective for plan years beginning in 2024. A starter plan accepts only pretax contributions and generally requires all employees to be auto-enrolled. Default pretax contributions range from 3% to 15%, up to the IRA contribution limit. Employees who are age 50 or older can contribute an additional \$1,000.

Part-time employees

SECURE 1.0 opened enrollment to long-term part-time employees. For these employees, 401(k) plans must have a dual-eligibility requirement under which they complete either one year of service (with the 1,000-hour rule) or three consecutive years of service, with at least 500 hours of service per year.

For plan years beginning in 2025, SECURE 2.0 reduces the three-year rule to two years. As under current law, these employees aren't entitled to an employer match.

Fixing mistakes

Auto-enrollment plans may seem to work on autopilot, but mistakes leading to hefty tax penalties can happen. While the IRS has procedures to correct mistakes, SECURE 2.0 goes further and provides a safe harbor for penalty-free corrections of reasonable mistakes. Mistakes must be corrected prior to nine-and-a-half months after the end of the plan year in which they occurred. This provision is effective for errors after Dec. 31, 2023.

Tax credit for start-up costs

Currently, employers with no more than 100 employees during the preceding year may take a tax credit equal to 50% of administrative costs, up to \$5,000.

For taxable years beginning in 2023, the credit increases to 100% for employers with up to 50 employees. These employers are also entitled to an additional credit equal to 100% for the first year of their matching contributions, up to a per-employee cap of \$1,000. Employees who earn more than \$100,000 are excluded from the credit computation. The credit is phased out in increments of 25%, until the fifth year, when it is 0%. Employers with 51 to 100 employees are eligible for a reduced credit.

Student loans

For contributions made for plan years beginning in 2025, employees who are paying back student loans may receive employer-matching contributions, up to the annual limits, less the pretax deductions they've already designated. Employees self-certify they've been paying back their loans and employers may rely on these certifications.

These provisions are in addition to the IRC § 127 provision allowing employers to repay up to \$5,250 in employees' student loans per year.

Incentives to participate

Employers can't offer cash incentives to employees to participate in their 401(k) plans.

For plan years beginning in 2023, employers may offer *de minimis* cash incentives, not paid for with plan assets, such as low-dollar gift cards, to boost participation in the plan. Unless the IRS says otherwise, however, these incentives are fully taxable.

Increasing retirement savings

Employees' income isn't limitless and financial pressures may deter them from fully participating in a 401(k) plan. SECURE 2.0 addresses some of these pressures.

Emergencies

Employees experience emergencies all the time. SECURE 2.0 contains four provisions to help employees get

through them.

- **After-tax Roth emergency savings accounts.** Plans may offer to enroll or auto-enroll non-highly compensated employees into 401(k)-linked emergency savings accounts. Accounts must be set up as Roth after-tax accounts. Contributions are limited to 3% of salary, up to \$2,500 a year (or a lower amount). Once the cap is reached, additional contributions can be directed into employees' Roth 401(k) accounts (if they have one) or stopped until the balance falls below the cap. Contributions are treated as elective deferrals for purposes of employer matching contributions. Employers may make matching contributions into the 401(k) portion of the plan. Employees are entitled to one withdrawal a month, and the first four withdrawals are fee-free. Notice provisions apply. For employees who are auto-enrolled, state anti-garnishment laws are overridden. These provisions are effective for plan years beginning in 2024.
- **Hardship distributions.** Plans may offer employees hardship distributions, but these distributions are subject to the 10% tax on early withdrawals if employees are younger than 59½. Effective for distributions made after Dec. 31, 2023, plans may allow penalty-free distributions for emergency expenses. *Maximum annual distribution:* \$1,000. Employees self-certify that they qualify for a distribution. Only one distribution every three years is permissible if employees don't pay back their previous distributions.
- **Domestic violence distributions.** For distributions made after Dec. 31, 2023, plans may permit employees who self-certify they are victims of domestic abuse to withdraw the lesser of \$10,000 or 50% of their account. Distributions are penalty-free. Employees can repay their distributions over three years.
- **Distributions related to terminal illnesses.** Distributions to employees who are diagnosed with a terminal illness and who are expected to die within 84 months are penalty-free. Employees' physicians must certify the illness and employees must present the certification to the plan administrator prior to taking distributions. This provision is effective for distributions made after Dec. 29, 2022.

Provisions to help older employees

The tax code already targets several provisions to older employees. SECURE 2.0 makes the following changes:

- Employees must begin to take required minimum distributions by the later of when they turn 72 or by April 1 of the year following their retirement. The age for RMDs increases to 73, starting Jan. 1, 2023, for employees who turn 72 after 2022. The age increases again to 75, starting in 2033, for employees who turn 74 after Dec. 31, 2032.
- Employees who are at least 50 years old can make pretax catch-up contributions. For taxable years beginning after Dec. 31, 2024, employees who are between 60–63 years old will be able to increase their catch-up contributions to the greater of \$10,000 or 150% more than the regular catch-up amount in 2024. *Catch:* All catch-up contributions will be required to be made on a Roth, after-tax basis. *Exception:* Employees earning less than \$145,000 during the preceding year may make pretax contributions or opt for Roth treatment.

Roth 401(k) provisions

Taxing 401(k) distributions can deter employees from participating. Contributions into Roth IRAs and 401(k) plans are *always* after-tax, so there are *no* taxes due on distributions. It's a good deal.

There are no RMDs for Roth IRAs prior to the account holder's death. Roth 401(k)s, however, aren't quite as generous. For taxable years beginning after Dec. 31, 2023, the pre-death distribution requirement is eliminated for Roth 401(k) plans.

Employers can't make matching or nonelective contributions into employees' Roth 401(k) accounts. For contributions made after Dec. 29, 2022, employers may make these contributions on a Roth basis, provided the contributions are fully vested when made.

Simplifying and clarifying the 401(k) plan rules

SECURE 2.0 simplifies some of the 401(k) plan rules.

- **Terminating employees.** Employers may transfer former employees' 401(k) accounts into IRAs if employees leave their accounts behind and the balance is between \$1,000 and \$5,000. For distributions made after Dec. 31, 2023, the mandatory cash-out balance increases to \$7,000.
- **Locating missing plan participants.** The Department of Labor is directed to create a lost-and-found database employees can use to locate old 401(k) assets. Plans will eventually need to provide the database with current and former employees' names and Social Security numbers. The database must be operational by 2024.
- **Furnishing notices.** Employers must distribute a battery of notices to employees, even those who don't participate in the plan. For plan years beginning after Dec. 31, 2022, provided all nonparticipants receive summary plan descriptions, employers need only furnish them with an annual reminder notice of their eligibility to participate and the election deadlines, and any required document they request.
- **Rollover forms.** Employees who terminate employment can avoid the 20% withholding tax on their distributions by directly rolling over those distributions into another plan or IRA. The IRS is required to simplify and standardize the rollover process by creating sample forms for incoming and outgoing plans to use. The IRS has until Jan. 1, 2025, to complete this task.