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SECURE 2.0 Makes Most Significant Retirement Plan Changes in Decades

On December 23, 2022, Congress passed the Consolidated Appropriations Act, 2023 (“the 2023 CAA”). The 2023 CAA is a 4,000-plus-page omnibus spending bill that earmarks \$1.7 trillion in discretionary funding for federal agencies, national defense, and aid for Ukraine. The 2023 CAA also includes the SECURE 2.0 Act of 2022 (“SECURE 2.0”), which includes the most significant changes affecting retirement plans that we have seen in decades. These changes expand upon the retirement plan changes made in the Setting Every Community Up for Retirement Enhancement Act of 2019 (“SECURE 1.0”), which were summarized in our prior [SECURE 1.0 Client Alert](#).

We previously described some expected SECURE 2.0 changes in our [2022 Employee Benefits Newsletter](#). This Client Alert summarizes the major SECURE 2.0 provisions and provides action steps for employers to implement these changes.

Changes That Are Effective Upon Enactment or January 1, 2023

Increased Required Minimum Distribution Age. Current law requires participants to begin distributions from their retirement plans at age 72, and failure to take such distributions results in a 50% excise tax. SECURE 2.0 increases the required minimum distribution age to 73 effective January 1, 2023 and age 75 effective January 1, 2033. The excise tax is reduced from 50% to 25%, with a further reduction to 10% for IRA distributions that are timely corrected.

Employer Matching or Nonelective Contributions Can Now Be Roth. Under current law, employer matching or nonelective contributions can be made only on a pre-tax basis. Effective immediately, 401(k), 403(b), and governmental 457(b) plans may provide participants with the option to receive matching or nonelective contributions on a Roth basis.

403(b) Investments. Effective immediately, collective investment trusts are included on the list of permitted investments for 403(b) custodial accounts. Prior to SECURE 2.0, 403(b) plans were limited to annuity contracts and mutual fund investments. We believe further action is required to update securities laws before most 403(b) plans can offer collective investment trusts.

In-Service Distributions for the Terminally Ill. Under current law, an additional 10% tax applies to early distributions from retirement plans. Effective immediately, the early withdrawal penalty does not apply to individuals with a terminal illness.

Eliminate the 457(b) "First Day of the Month Rule." Current law requires governmental 457(b) participants to request deferral election changes prior to the beginning of the month in which the deferral will be made. Effective January 1, 2023, participants can now request changes to their elections at any time prior to the date that the compensation being deferred is payable, which matches the rule for 401(k) and 403(b) plans.

Cash Balance Plans. Current law subjects cash balance and other hybrid plans to technical rules that make it difficult to offer market-based designs. Effective for plan years beginning after December 29, 2022, cash balance plans with variable interest crediting rates may use a projected interest credit rate that is "reasonable" and does not exceed 6%. This means plans may continue to include graded pay credits that increase for older, longer-service workers without the risk of failing the anti-backloading rules that created problems for plans that used market-based interest crediting rates.

Military Spouse Eligibility Tax Credit. Effective for taxable years beginning after December 29, 2022, small employers (100 or fewer employees) can receive a tax credit if they make military spouses (1) immediately eligible for plan participation within two months of hire, (2) eligible for any matching or nonelective contribution that they would have been otherwise eligible for at two years of service, and (3) 100% immediately vested in all employer contributions. The credit is \$200 per participating non-highly-compensated military spouse employee plus 100% of employer contributions, up to an additional \$300 per employee. The credit is available for up to three years, and employers may rely on an employee's certification that they are a military spouse.

Small Employer Plan Startup Credit. Effective for taxable years beginning after December 31, 2022, the startup credit increases from 50% to 100% of administrative costs for small employers with up to 50 employees. The credit remains 50% for employers with 51-100 employees. Employers may also receive an additional credit based on the amount of employer contributions of up to \$1,000 per employee. This additional credit phases out for employers with 51-100 employees and phases out over five years. The additional credit does not apply to defined benefit plans. The startup credit is also available to employers that join an existing multiple employer plan, regardless of how long the plan has been in existence.

Eliminating Unnecessary Disclosures for Unenrolled Participants. Effective for plan years beginning after December 31, 2022, employers are no longer required to provide most intermittent ERISA or Code notices to unenrolled participants who have not elected to participate in an employer's retirement plan. Employers are required to provide (1) an annual reminder notice of the participant's eligibility to participate in the plan and any applicable election deadlines, and (2) any plan documents requested by the participant.

Hardship Distributions. Current law allows distributions on account of immediate and heavy financial need or an unforeseeable emergency, and the amount must be limited to the amount necessary to satisfy the financial need. Certain listed events are deemed to be on account of hardship, and employees are required to submit records documenting the safe harbor event. Effective for plan years beginning after December 29, 2022, plan administrators can rely on employee self-certification that they experienced a safe harbor event and that the requested amount does not exceed the amount required to satisfy the financial need.

Federally Declared Disasters. SECURE 2.0 provides permanent special rules governing plan distributions and loans in cases of federally declared disasters. Previously, Congress established rules for each disaster. The new rules allow for penalty-free distributions of up to \$22,000 per participant per disaster,

and participants can recontribute distributed amounts to the plan within three years. Plans may also increase loan limits to the lesser of \$100,000 or an affected participant's total vested account balance and extend repayment periods for outstanding loans by one year. This provision is retroactive and applies to disasters occurring on or after January 26, 2021.

Changes That Are Effective January 1, 2024

Employers Can Treat Student Loan Payments as Elective Deferrals for Matching Purposes. Starting in 2024, employers may make a matching contribution to a 401(k), 403(b), governmental 457(b), or SIMPLE IRA plan with respect to an employee's qualified student loan payment. Furthermore, plans subject to Actual Deferral Percentage testing may separately test employees who receive matching contributions based on student loan repayments.

Catch-up Contributions Must Be Roth Contributions. Under current law, catch-up contributions can be made on a pre-tax or Roth basis (if permitted by the plan sponsor). Effective for taxable years beginning after December 31, 2023, all age 50+ catch-up contributions made by employees making more than \$145,000 per year must be made to Roth accounts.

Force-Out Distributions. Current law permits employers to transfer a former employee's workplace retirement account to an IRA if the balance is between \$1,000 and \$5,000. Effective for distributions after December 31, 2023, the upper limit is increased to \$7,000. Additionally, retirement plan service providers will be permitted to offer automatic portability services from a default IRA to the participant's new employer's retirement plan, unless the participant affirmatively elects otherwise.

Hardship Distributions. Effective for plan years beginning after December 31, 2023, SECURE 2.0 conforms the 403(b) hardship rules to the rules for 401(k) plans.

Penalty-Free In-Service Withdrawals. SECURE 2.0 makes it easier for employees to access accumulated funds in their retirement plan by allowing plans to permit penalty free distributions in certain situations. Domestic abuse survivors may withdraw up to the lesser of \$10,000 or 50% of the participant's account balance, and the participant may repay the withdrawal to the plan within three years. Additionally, a participant may receive one penalty-free withdrawal per year of up to \$1,000 for unforeseeable or immediate financial needs relating to personal or family emergency expenses. The participant may repay the withdrawal to the plan within three years, and no other emergency withdrawals are allowed during the repayment period unless the participant repays the withdrawal to the plan. These provisions are effective for distributions after December 31, 2023.

Section 529 Rollovers. Effective for distributions after December 31, 2023, beneficiaries of 529 college savings accounts may roll over up to \$35,000 from any 529 account in their name to their Roth IRA over the course of their lifetime. These rollovers are subject to Roth IRA annual contribution limits, and the 529 account must have been open for more than 15 years.

Roth Required Minimum Distributions. Under current law, required minimum distributions from Roth IRAs are not required to begin prior to the account owner's death, but required minimum distributions from Roth-designated accounts in employer retirement plans must begin at age 72. SECURE 2.0 eliminates the pre-death distribution requirement for Roth accounts in employer plans for taxable years beginning after December 31, 2023. However, this change does not apply to distributions that are required with respect to years beginning before January 1, 2024 but are permitted to be paid on or after such date.

Top-Heavy Testing. Effective for plan years beginning after December 31, 2023, employers may perform top-heavy testing separately on non-excludible and excludible employees. This conforms top-heavy testing with the other nondiscrimination testing that already permits this separate testing.

Starter Plans. Employers that do not sponsor a retirement plan may offer a new type of plan, a “starter” 401(k) or 403(b) plan. Starter plans are deferral-only arrangements that enroll all employees at a deferral rate of 3% to 15% of their compensation. The annual deferral limit is the same limit applied to IRAs. These starter plans are safe harbor plans that are exempt from nondiscrimination and top-heavy testing requirements. Starter plans may be established for plan years beginning after December 31, 2023.

SIMPLE Plan Conversion. Effective for plan years beginning after December 31, 2023, employers may replace a SIMPLE IRA plan during the plan year with a SIMPLE 401(k) plan or other 401(k) plan that requires mandatory employer contributions.

Additional Nonelective Employer Contributions to SIMPLE Plans. Effective for taxable years beginning after December 31, 2023, employers with SIMPLE plans may make additional employer contributions above the existing 2% of compensation or 3% of employee elective deferrals requirement. Additional employer contributions must be made in a uniform manner and cannot exceed the lesser of 10% of compensation or \$5,000 (indexed to inflation).

Emergency Savings Account. Effective for plan years beginning after December 31, 2023, employers may offer non-highly-compensated employees an option to link an emergency savings account to their retirement plan. Employers may automatically opt employees into these accounts at no more than 3% of their salary, and the employee's contribution is capped at \$2,500. Contributions up to the cap are made on a Roth-like basis and are treated as elective deferrals for matching purposes. Plans may not charge fees for the first four withdrawals from the account each plan year. At separation from service, employees may take their emergency savings accounts as cash or roll it into their Roth defined contribution plan (if they have one) or IRA.

Changes That Are Effective January 1, 2025 and Beyond

Automatic Retirement Plan Enrollment. Effective for plan years beginning after December 31, 2024, new 401(k) and 403(b) plans must automatically enroll participants, unless employees affirmatively opt out of such enrollment. Initial deferral amounts must be at least 3% but no more than 10% of the employee's compensation, with automatic annual increases of 1% until the deferral amount is at least 10% but no more than 15%. All current 401(k) and 403(b) plans are grandfathered, and there is an exception for small businesses with 10 or fewer employees, entities that have been in business for less than three years, church plans, and governmental plans.

Part-Time Employee Eligibility. Under SECURE 1.0, effective with the 2024 plan year, long-term, part-time employees must be allowed to contribute to 401(k) plans after three consecutive years with 500 or more hours of service. Employees eligible for this provision also earn vesting credit for years with 500 hours of service. Twelve-month periods beginning before January 1, 2021 are disregarded for eligibility purposes, but the law did not limit the look-back period for vesting purposes. SECURE 2.0 adds a look-back period for vesting purposes and reduces the three-year rule to two years for plan years beginning after December 31, 2024. Pre-2023 service is disregarded for both eligibility and vesting purposes under the two-year rule. Unfortunately, the SECURE 1.0 rule still applies for 2024. Additionally, the new two-year rule for long-term, part-time employees will also apply to ERISA Section 403(b) plans.

Additional Catch-Up Contributions. Under current law, employees aged 50 or older in 2023 are permitted to make catch-up contributions of \$7,500 (\$3,500 for SIMPLE plans) in excess of otherwise applicable annual limits. Effective for taxable years beginning after December 31, 2024, SECURE 2.0 creates an additional “tier” of catch-up contributions for individuals who are ages 60, 61, 62 and 63. Such individuals will have an increased catch-up limit of \$10,000 or 150% of the regular catch-up amount, whichever is greater. The increased amounts are indexed for inflation after 2025.

Benefit Statements. Effective for plan years beginning after December 31, 2025, defined contribution plans must provide a paper benefit statement at least once annually, unless a participant elects otherwise. The other three quarterly statements required under ERISA may be provided electronically. Defined benefit plans must provide a paper benefit statement at least once every three years, unless a participant elects otherwise.

Saver's Match Becomes a Federal Matching Contribution. Current law provides for a nonrefundable credit for certain individuals who make contributions to IRAs, employer retirement plans, and ABLE accounts. For taxable years beginning after December 31, 2026, this tax credit is replaced by a “federal matching contribution” credit, received by the taxpayer as part of their tax refund that must be deposited into the taxpayer's IRA or retirement plan. The match is 50% of IRA or retirement plan contributions up to \$2,000 per individual for those below the adjusted gross threshold (\$41,000 for joint filers and \$20,500 for single taxpayers or those married filing separately). The match phases out above the threshold and ceases when the participant's adjusted gross income exceeds \$71,000 (joint filers) or \$35,500 (single or married filing separately).

Expansion of Gain Deferral for ESOP Stock Sales. Code Section 1042 currently allows an individual owner of stock in a non-publicly traded C corporation to defer recognition of gain from the sale of company stock to the ESOP. Effective for stock sold after December 31, 2027, gain deferral is allowed for the sale of stock to S corporation ESOPs, but deferral is limited to 10% of gains. The 10% limit does not apply to sales to C corporation ESOPs.

Future Regulations

SECURE 2.0 provides some clues as to future regulations and rulemaking, including:

EPCRS Expansion. The Employee Plans Compliance Resolution System (“EPCRS”) is expanding to allow more types of errors (such as plan loan and automatic deferral errors) to be self-corrected and exempt certain failures from excise taxes. The IRS is required to issue revised Revenue Procedures within two years.

Participant Notices and Plan Reporting. SECURE 2.0 directs applicable departments and agencies to review and revise regulations covering multiple areas. We expect to see updated guidance in the following areas:

- Consolidating separate defined contribution plan notices into a single notice
- Improving fee disclosures required for defined contribution plans
- Simplifying and consolidating defined benefit plan reporting and disclosure requirements

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Retirement Savings Lost and Found Database. SECURE 2.0 directs the Department of Labor to create and maintain a national online database that will help participants find contact information for retirement plan administrators. Plans will have annual reporting requirements regarding participants who separated with vested benefits, and we expect additional guidance to clarify the scope of information required and how such information will be reported.

Next Steps

In light of the significant operational changes required by SECURE 2.0, plan sponsors will need to closely coordinate with their recordkeepers and document vendors to decide what operational changes to make and keep good records of those changes for when plan amendments are required. Specifically, plan sponsors should consider the following for provisions that are effective in the near term or require action now for later implementation:

- Decide whether to offer participants the option to receive matching contributions on a Roth basis.
- Decide whether to make self-certification available for hardship withdrawals and coordinate with service providers regarding how self-certification will be handled.
- Decide whether to implement a Roth feature now to be prepared for catch-up contribution changes if the plan does not currently allow Roth contributions.
- If your 401(k) or 403(b) plan applies a service condition before being eligible to make deferrals, begin tracking hours for the two years with 500 hours of service requirement or consider plan design changes.
- Review how notices are being distributed to non-participating employees and update your process to take advantage of the new rules.

Plan sponsors must adopt amendments to implement mandatory and any desired optional SECURE 2.0 provisions by the end of the first plan year that starts in 2025. Governmental plan sponsors have until the end of the 2027 plan year.

If you have any questions about SECURE 2.0 or how its changes impact your retirement plans, contact one of the members of Kutak Rock's [Employee Benefits and Executive Compensation practice group](#).

