# SECURE 2.0 Act of 2022

## Cross References

- H.R. 2617, *Consolidated Appropriations Act, 2023*

Signed into law on December 29, 2022, Division T of the Consolidated Appropriations Act, 2023, includes the "SECURE 2.0 Act of 2022," which is a continuation of the "Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act of 2019)."

The new law is designed to help taxpayers save more for retirement. The following is our coverage of the retirement provisions.

## Automatic Enrollment in Retirement Plans (IRC §414A)

According to the Congressional summary of the new law, one of the main reasons many Americans reach retirement age with little or no savings is that too few workers are offered an opportunity to save for retirement through their employers. However, even for those employees who are offered a retirement plan at work, many do not participate. But automatic enrollment in 401(k) plans – providing for people to participate in the plan unless they take the initiative to opt out – significantly increases participation. Since first defined and approved by the Treasury Department in 1998, automatic enrollment has boosted participation by eligible employees generally, and particularly for Black, Latinx, and lower-wage employees. An early study found that adoption of automatic enrollment increased participation in a 401(k) plan by short-tenure Latinx employees from 19% to 75%. An Ariel/Aon-Hewitt study found that, in plans using automatic enrollment, "the most dramatic increases in enrollment rates are among younger, lower-paid employees, and the racial gap in participation rates is nearly eliminated among employees subject to auto-enrollment."

**New law.** Effective for plan years beginning after December 31, 2024, a 401(k) plan and a 403(b) annuity plan is required to contain automatic enrollment provisions that meet all of the following.

1) The plan is an eligible automatic contribution arrangement:
   a) Under which a participant may elect to have the employer make payments as contributions under the plan on behalf of the participant, or to the participant directly in cash, and
   b) Under which the participant is treated as having elected to have the employer make such contributions (automatic contributions) unless the participant specifically elects not to have such contributions made, or specifically elects to have contributions made at a different percentage.
2) The plan allows employees to elect to withdraw the automatic contributions (and the earnings attributable to such contributions) if the election is made within 90 days of the date of the first automatic contribution. If this election is made, the distribution must equal the total of all automatic contributions beginning with the first payroll period up to the effective date of the election (including earnings).

 

3) The uniform percentage of compensation contributed by the participant under the automatic enrollment provision during the first year of participation must be at least 3% and not more than 10%, unless the participant specifically elects not to have contributions made, or specifically elects to have contributions made at a different percentage. The contribution percentage is increased by 1% each year after the first year (to at least 10%, but not more than 15%) unless the participant specifically elects not to have contributions made, or specifically elects to have contributions made at a different percentage.
4) The plan must meet certain investment requirements.

The automatic enrollment provisions do not apply to any of the following.
- SIMPLE plans.
- 401(k) or 403(b) plans that were established before December 29, 2022.
- Any governmental plan or church plan.
- An employer that has been in existence for less than three years.
- A small business that normally employs 10 or fewer employees.

## Credit for Small Employer Pension Plan Startup Costs (IRC §45E)

IRC section 45E allows for a general business credit equal to 50% of the qualified pension plan startup costs paid or incurred by a taxpayer during the year. The credit is generally limited to the greater of:
1) $500, or
2) The lesser of:
   a) $250 for each employee of the eligible employer who is not a highly compensated employee and who is eligible to participate in the plan, or
   b) $5,000

Pension plan startup costs are the ordinary and necessary expenses which are paid in connection with the establishment or administration of an eligible employer plan, or the retirement-related education of employees with respect to such plan. The plan must have at least one employee participate in the plan.

Eligible employers are generally those with no more than 100 employees who received at least $5,000 of compensation for the preceding year.

**New law.** Effective for tax years beginning after December 31, 2022, the new law increases the credit from 50% to 100% for certain small employers with no more than 50 employees.

The new law also provides for an additional credit for employer contributions by certain small employers equal to the applicable percentage of employer contributions (other than employee elective deferrals) (does not apply to defined benefit plans). This additional credit is limited to $1,000 per employee. This credit begins to phase out for employers with more than 50 employees. The credit is fully phase-out for employers with 100 or more employees.

The additional credit does not apply with respect to any employee who receives wages in excess of $100,000. This $100,000 threshold is indexed for inflation after the 2023 calendar year.

The applicable percentage is 100% for the first year the employer plan is established. For tax years thereafter, the applicable percentage is determined as follows.

| | |
|---|---|
| Year 2 | 100% |
| Year 3 | 75% |
| Year 4 | 50% |
| Year 5 | 25% |
| Year 6 and after | 0% |

No deduction is allowed for the portion of the qualified start-up costs which is equal to the start-up cost credit, and no deduction is allowed for the portion of the employer contributions which is equal to the additional credit for employer contributions.

## Saver's Match (IRC §6433)

Current law provides for a nonrefundable income tax credit for certain low-income individuals who make contributions to individual retirement accounts ("IRAs"), employer retirement plans (such as 401(k) plans), and ABLE accounts.

**New law.** Effective for tax years beginning after December 31, 2026, the new law creates new IRC section 6433 called the "Saver's Match," which repeals the credit with respect to IRA and retirement plan contributions, and replaces it with a tax credit that is paid by the IRS as a contribution to the eligible individual's applicable retirement savings vehicle when he or she makes a qualified retirement savings contribution for the tax year. The matching contribution equals the applicable percentage of the qualified retirement savings contribution that is made by the eligible individual, not to exceed $2,000.

The saver's match is treated as an elective deferral made by the individual, or as an individual retirement plan contribution made by the individual. The saver's match is not taken into account with respect to any applicable limitations that otherwise apply to elective deferrals or retirement plan contributions.

**Match less than $100.** If the matching contribution is greater than zero but less than $100 for the tax year, the taxpayer can elect to have the match treated as a tax credit on the tax return rather than as a contribution to the taxpayer's applicable retirement savings vehicle.

**Applicable percentage.** The applicable percentage is 50%. This percentage begins to phase out when the taxpayer's modified adjusted gross income (AGI) exceeds:
- $41,000 for MFJ and QSS.
- $30,750 for HOH.
- $20,500 for Single and MFS.

The saver's match is completely phase-out when the taxpayer's modified AGI reaches:
- $71,000 for MFJ and QSS.
- $53,250 for HOH.
- $35,500 for Single and MFS.

These phase-out amounts are adjusted for inflation beginning in 2028.

Modified AGI is AGI determined without regard to:
- Foreign earned income exclusion,
- Income excluded from sources within Guam, American Samoa, or the Northern Mariana Islands,
- Income excluded from sources within Puerto Rico, and
- Any exclusion or deduction allowed for any qualified retirement savings contribution made during the year.

**Eligible individual.** An eligible individual is an individual who is at least age 18, and:
- Is not a dependent of another taxpayer (as defined under IRC section 151),
- Is not a full time student for at least five calendar months during the year [as defined under IRC section 152(f)(2)], and
- Is not a nonresident alien unless such individual elects to be treated as a resident for tax purposes.

**Qualified retirement savings contributions.** Qualified retirement savings contributions include the following.
- IRA contributions,
- Elective deferrals to a 401(k) plan,
- Elective deferrals to a 403(b) plan,
- Elective deferrals to a SIMPLE plan,
- Elective deferrals to a 457(b) plan, and
- Voluntary employee contributions to any qualified retirement plan.

**Reduction for certain distributions.** Qualified retirement savings contributions for the year are reduced by the aggregate distributions received by the individual during a testing period, which generally includes the current tax year, the two preceding tax years, and the period after the current tax year and before the due date (including extensions) for filing the current tax year return.

Exceptions to this reduction rule apply for various reasons, such as when excess contributions are distributed by a 401(k) or when the distribution is a transfer or rollover. See IRC section 6433(d)(2)(C) for a complete list of excepted distributions.

Distributions received by a spouse will also reduce the amount of qualified retirement savings contributions if the taxpayer files a joint return with his or her spouse.

**Applicable retirement savings vehicle.** An applicable retirement savings vehicle is generally any retirement plan listed above under "qualified retirement savings contributions." However, it does not include elective deferrals as Roth contributions under IRC section 402A, or a Roth IRA. The IRS is directed to issue guidance as to how a taxpayer designates his or her retirement plan as an applicable retirement savings vehicle.

**Author's Comment**

For example, the IRS could include a section on the tax return to enter account information that identifies a specific retirement account in which the IRS is directed to make a direct payment of the saver's match on behalf of the taxpayer. Similar as to how the IRS currently issues direct deposits of the taxpayer's refund into the taxpayer's bank account.

**Erroneous matching.** Any amount paid by the IRS into the taxpayer's retirement savings vehicle that is erroneously paid is treated as an underpayment of tax for the tax year in which the IRS determines the payment is erroneous. To avoid the increase in tax, such amount can be distributed without penalty if it is distributed no later than the filing deadline (including extensions) for filing the return for such tax year.

**Saver's match recovery payments.** The new law includes rules on how to recover all or a portion of the saver's match if the taxpayer takes an early distribution, and the aggregate amount of the saver's match exceeds the account balance of such savings vehicle at the end of the tax year. Any excess amount is recovered in the form of an additional tax equal to such excess, reduced by the early withdrawal penalty under IRC section 72(t). The taxpayer can avoid the additional tax by electing to contribute such excess back into the applicable retirement savings vehicle by the due date (including extensions) for filing the tax return.

The IRS is directed to issue guidance in cases where the excess is allocable to investment losses in the retirement savings vehicle.

**Promotion of saver's match.** The IRS is directed to increase public awareness of the saver's match, including the adverse consequences of early withdrawal from an applicable retirement savings vehicle.

## Multiple Employer 403(b) Plans

Multiple employer plans ("MEPs") provide an opportunity for small employers to band together to obtain more favorable retirement plan investment results and more efficient and less expensive management services. The SECURE Act of 2019 made MEPs more attractive by eliminating outdated barriers to the use of MEPs and improving the quality of MEP service providers.

**New law.** Effective for plan years beginning after 2022, the new law allows 403(b) plans, which are generally sponsored by charities, educational institutions, and non-profits, to participate in MEPs and pooled employer plans (PEPs), including relief from the one bad apple rule so that the violations of one employer do not affect the tax treatment of employees of compliant employers.

 

## Increase in Age for Required Beginning Date for Mandatory Distributions [IRC §401(a)]

Prior to 2020, taxpayers in general were required to begin taking required minimum distributions (RMDs) from qualified retirement plans and IRAs by April 1 of the calendar year following the calendar year in which the individual reaches age 70½. Each subsequent RMD after the first year must be made by December 31 of each year.

Under the SECURE Act of 2019, the 70½ age threshold was increased to age 72, effective for distributions required to be made after December 31, 2019.

Under the CARES Act, no minimum distributions were required for calendar year 2020. Thus, the first calendar year the age 72 threshold applied was for 2021 (RMDs required to begin by April 1 of 2022 for individuals turning age 72 in 2021).

**New law.** The new law replaces the age 72 threshold with the following age thresholds.

1) Age 73 starting in 2023.
2) Age 75 starting in 2033.

> **Author's Comment**
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> Individuals who attain age 74 in 2033 would not need to start taking RMDs until 2034, the year they attain age 75.

## Indexing IRA Catch-Up Limit [IRC §219(b)]

The inflation adjusted IRA contribution amount for 2023 is $6,500. For individuals age 50 and over, an additional $1,000 catch-up contribution is allowed for a combined 2023 limit of $7,500.

Each year, the regular contribution amount is indexed for inflation. However, the $1,000 catch-up amount is not indexed for inflation, which has been $1,000 since the 2006 tax year.

**New law.** Beginning with the 2024 calendar year, the $1,000 catch-up amount is indexed for inflation.

## Higher Catch-up Limit to Apply at Age 60, 61, 62, and 63 [IRC §414(v)]

The inflation adjusted 401(k)/403(b) elective deferral limit for 2023 is $22,500. For individuals age 50 and over, an additional $7,500 catch-up contribution is allowed for a combined 2023 limit of $30,000. Both the elective deferral limit and the catch-up limit are indexed each year for inflation.

The inflation adjusted SIMPLE elective deferral limit for 2023 is $15,500. For individuals age 50 and over, an additional $3,500 catch-up contribution is allowed for a combined 2023 limit of $19,000. Both the elective deferral limit and the catch-up limit are indexed each year for inflation.

**New law.** Effective for tax years beginning after December 31, 2024, the catch-up elective deferral limits are increased for eligible participants who attain ages 60, 61, 62, and 63 before the close of the tax year.

For purposes of the 401(k)/403(b) increased catch-up limits, the adjusted dollar amount is the greater of $10,000, or 50% more than the regular catch-up amount (150% of the regular catch-up amount).

For purposes of the SIMPLE increased catch-up limits, the adjusted dollar amount is the greater of $5,000, or 50% more than the regular catch-up amount (150% of the regular catch-up amount).

The new law also adjusts the indexing calculations for the age 60 through 63 catch-up limits for tax years beginning after 2025.

## Student Loan Payments Treated as Elective Deferrals for Purposes of Matching Contributions [IRC §401(m)]

It is common for an employer to make matching contributions on behalf of an employee participant in a 401(k) retirement plan (or similar plan that allows employer's to match employee elective deferrals). The employer match is generally a percentage of the employee's elective deferrals.

Congress believes that many who are overwhelmed with student debt do not participate in 401(k) plans and thus miss out on matching contributions by their employer.

**New law.** Effective for plan years beginning after December 31, 2023, the new law allows employers to make matching contributions into a participant's retirement account when the employee makes a qualified student loan payment.

**Qualified student loan payment.** A qualified student loan payment is a payment made by an employee in repayment of a qualified education loan incurred by the employee to pay qualified higher education expenses, but only:

1) To the extent the payments in the aggregate for the year do not exceed an amount equal to:
   a) The elective deferral limitation for the year, or if lesser, the employee's compensation for the year, reduced by
   b) The elective deferrals made by the employee for the year, and
2) If the employee certifies annually to the employer that such payment had been made on the student loan.

**Matching contributions.** The matching contribution on account of a qualified student loan payment will be treated as a matching contribution to a defined contribution plan if:

1) The plan provides matching contributions on account of elective deferrals at the same rate as contributions on account of qualified student loan payments,
2) The plan provides matching contributions on account of qualified student loan payments only on behalf of employees otherwise eligible to receiving matching contributions on account of elective deferrals,
3) All employees eligible to receive matching contributions on account of elective deferrals are eligible to receive matching contributions on account of qualified student loan payments, and

4) The plan provides that matching contributions on account of qualified student loan payments vest in the same manner as matching contributions on account of elective deferrals.

**Nondiscrimination rules.** A plan that allows for matching contributions on account of qualified student loan payments will not fail the nondiscrimination rules solely because an employee does not have student loan debt. Plans are permitted to test separately the employees who receive matching contributions on student loan repayments.

**Student loan payments.** A student loan payment is not a contribution to a retirement plan. However, it may be treated as a contribution for purposes of meeting the matching contribution rules. An employer may rely on the employee's certification that the employee made a qualified student loan payment when making a matching contribution into the employee's retirement plan.

**Types of elective deferrals.** The following types of elective deferral plans can adopt of policy to match qualified student loan payments.
- 401(k) elective deferrals,
- 403(b) elective deferrals,
- Simple elective deferrals, and
- 457(b) plans.

## Military Spouse Retirement Plan Eligibility Credit for Small Employers [IRC §45AA]

Military spouses often do not remain employed long enough to become eligible for their employer's retirement plan or to vest in employer contributions.

**New law.** Effective for tax years beginning after 2022, the new law provides small employers a tax credit with respect to their defined contribution plans if they:
1) Make military spouses immediately eligible for plan participation within two months of hire,
2) Upon plan eligibility, make the military spouse eligible for any matching or non-elective contribution that they would have been eligible for otherwise at two years of service, and
3) Make the military spouse 100% immediately vested in all employer contributions.

The credit equals the sum of:
1) $200 for each military spouse employed by the small business who participates in an eligible defined contribution plan of the employer, plus
2) 100% of the contributions made by the employer (other than elective deferrals) to the retirement plans of all employees during the tax year, not to exceed $300.

The credit applies to the first three tax years an individual is taken into account as a military spouse.

An eligible small employer is one with no more than 100 employees who received at least $5,000 of compensation from the employer for the preceding year.

A military spouse is an individual married to an individual who is a member of the uniformed services serving on active duty. An employer may rely on the employee's certification that the employee's spouse is a member of the uniformed services. A military spouse does not include an employee that is a highly compensated employee under IRC section 414(q).

## Small Immediate Financial Incentives for Contributing to a Plan [IRC §401(k)]

An employee is not required to participate in a 401(k) plan. The employee can choose to receive compensation in the form of cash rather than electing to defer receipt of the money by having it contributed into the employee's retirement account.

IRC section 401(k)(4)(A) prohibits an employer from offering other benefits to the employee either directly or indirectly that are contingent on the employee electing to contribute to a retirement plan in lieu of receiving cash.

**New law.** Effective for plan years beginning after December 29, 2022, the new law allows for a de minimis financial incentive (not paid for with plan assets) provided to employees who elect to have the employer make contributions under the arrangement in lieu of receiving cash.

The de minimis exception applies to 401(k) and 403(b) plans.

**Author's Comment**

The text of the new law does not define the term "de minimis financial incentive." However, the Congressional summary of the new law mentions low-dollar gift cards as an example of a de minimis financial incentive.

## Deferral of Tax for Certain Sales of Employer Stock to Employee Stock Ownership Plan Sponsored by S Corporation (IRC §1042)

In general, the sale of stock is a taxable transaction. An exception applies when the sale is to an employee stock ownership plan that meets the requirements under IRC section 1042. This exception only applies to stock in a domestic C corporation.

**New law.** Effective for sales after December 31, 2027, the "domestic C corporation" requirement is replaced with a "domestic corporation" requirement, which means that domestic S corporations can also offer employee stock ownership plans to their employees. The new law includes a 10% limitation in the case of the sale of qualified securities of an S corporation.

## Withdrawals for Certain Emergency Expenses [IRC §72(t)(2)(I)]

IRC section 72(t) imposes a 10% penalty tax (in addition to the regular tax) on the early distribution from a qualified retirement plan. An early distribution is generally a distribution made before the participant attains the age of 59½. IRC section 72(t) includes a number of exceptions to the 10% early withdrawal penalty.

**New law.** Effective for distributions made after December 31, 2023, a new exception to the penalty applies to withdrawals for certain emergency personal expenses.

Not more than one distribution per calendar year may be treated as an emergency personal expense distribution. The distribution is limited to the lesser of $1,000 or an amount equal to the excess of:

1) The individual's total non-forfeitable accrued benefit under the plan (the individual's total interest in the plan in the case of an individual retirement plan), determined as of the date of each such distribution, over
2) $1,000.

**Emergency personal expense distribution.** The term "emergency personal expense distribution" means any distribution from an applicable eligible retirement plan to an individual for purposes of meeting unforeseeable or immediate financial needs relating to necessary personal or family emergency expenses.

**Repayment.** An individual may repay the distribution back into the plan within three years of the distribution, which in turn treats the distribution as either a trustee to trustee transfer, or as rollover, and thus avoid paying regular tax on the distribution.

**Limit on subsequent distributions.** If a taxpayer takes an emergency personal expense distribution during a tax year, no amount may be treated as an emergency personal expense distribution during the immediately following three calendar years, unless the previous distribution is fully repaid, or the aggregate of the elective deferrals and employee contributions to the plan subsequent to the previous distribution is at least equal to the amount of the previous distribution.

## Elective Deferral Limits and Employer Matching Contributions to SIMPLE Plans [IRC §408(p)]

Employees who participate in a SIMPLE plan are allowed to make elective deferrals of up to $15,500 for tax year 2023 ($19,000 for participants age 50 and over). These amounts are adjusted each year for inflation.

In general, unless the employer chooses to make non-elective contributions to a SIMPLE plan, the employer must match employee elective deferrals dollar-for-dollar up to 3% of the employee's compensation for the year. A special rule allows the employer to reduce the 3% limit to not less than 1% for not more than 2 out of 5 years. No matching is required for employees who do not elect to defer wages into the plan.

Rather than being subject to the 3% of compensation matching rule, an employer can choose to make non-elective contributions on behalf of all eligible employees, including those employees who choose not to make elective deferrals into the plan. The non-elective contributions must equal 2% of employee compensation.

Employee compensation for purposes of the employer match is limited to $330,000 for tax year 2023 (adjusted each year for inflation). Thus, the maximum employer matching contribution allowed per employee in 2023 is $9,900 ($330,000 × 3%).

 

**New law.** For tax years beginning after December 31, 2023, an employer can choose to make non-elective contributions of a uniform percentage (for all employees) at a rate up to 10% of compensation for each employee who is eligible to participate, and who has at least $5,000 of compensation from the employer for the year. However, the non-elective contribution by the employer for each employee cannot exceed $5,000 for the year. The $5,000 limit is adjusted each year for inflation.

The new law also increases the elective deferral limit to 110% of the otherwise applicable elective deferral limit if the employer has no more than 25 employees (who have at least $5,000 in compensation for the year), or a large employer with more than 25 employees elects to have the higher 110% limit apply. This 110% limit also applies to the catch-up elective deferrals allowed for employees age 50 and older.

If a large employer with more than 25 employees elects to have the higher 110% limit apply for employee elective deferrals, then the employer's 3% match for participating employees is increased to 4%.

If a large employer with more than 25 employees elects to have the higher 110% limit apply for employee elective deferrals and the employer chooses to make non-elective contributions for all employees, the 2% match for all eligible employees is increased to 3%.

There is a 2-year grace period for small employers with no more than 25 employees who have at least $5,000 of compensation for the year. If the employer has more than 25 employees for any subsequent year, the employer will be treated as having no more than 25 employees for the two years following the last year the employer has no more than 25 employees.

These increased limit rules do not apply if the employer had another qualified plan within the three years immediately preceding the first year the employer maintains a SIMPLE plan.

## Non-Trade SEP Contributions

Under prior law, only trades or businesses were allowed to set up SEP plans for their employees.

**New law.** Effective for tax years beginning after December 29, 2022, any employer can set up a SEP plan for a domestic employee. For example, a household employer who sets up a SEP plan for a nanny.

## Section 415 Limit for Certain Employees of Rural Electric Cooperatives

IRC section 415 generally limits the amount that may be paid by a defined benefit pension plan in annual benefits to a participant to the lesser of $265,000 (2023 inflation adjusted amount), or 100% of the participant's average compensation.

**New law.** Effective for limitation years ending after December 29, 2022, the compensation-based limit is eliminated for participants who are non-highly compensated employees and participate in a rural electric cooperative retirement plan.

 

## Exemption for Certain Automatic Portability Transactions

Under current law, an employer is permitted to distribute a participant's account balance without participant consent if the balance is under $5,000 and the balance is immediately distributable (e.g., after a termination of employment). Current law also requires an employer to roll over this distribution into a default IRA if the account balance is at least $1,000 and the participant does not affirmatively elect otherwise.

**New law.** Effective for transactions occurring on or after December 29, 2023 (the date which is 12 months after the date of enactment of this new law), a retirement plan service provider is permitted to provide employer plans with automatic portability services. Such services involve the automatic transfer of a participant's default IRA (established in connection with a distribution from a former employer's plan) into the participant's new employer's retirement plan, unless the participant affirmatively elects otherwise.

## Starter 401(k) Plans for Employers With No Retirement Plan [IRC §401(k)]

In order to meet the non-discrimination rules that apply to all defined contribution plans, a qualified plan that permits employee elective deferrals (such as a 401(k) plan) must meet the actual deferral percentage (ADP) test [IRC §401(k)(3)]. This test prevents a highly-compensated employee from deferring a greater percentage of his or her compensation than a non-highly-compensated employee.

**New law.** Effective for plan years beginning after December 31, 2023, a starter 401(k) deferral-only arrangement maintained by an eligible employer is treated as meeting the ADP test under IRC §401(k)(3)(A)(ii).

A starter 401(k) deferral-only arrangement must meet all of the following.
- The automatic deferral requirements,
- The contribution limitations, and
- The notice requirements under IRC section 401(k)(13)(E).

**Automatic deferral.** Each eligible employee is treated as having elected to have the employer make elective contributions in an amount equal to a qualified percentage of compensation. An employee can make an affirmative election to not have the employer make elective deferrals, or to make elective deferrals at a level specified in the affirmative election.

**Qualified percentage.** A qualified percentage of compensation for purposes of automatic deferrals is any percentage determined under the arrangement if it is applied uniformly and is not less than 3% or more than 15%.

**Contribution limitations.** Under a starter 401(k) deferral-only arrangement:
- The only contributions which may be made are elective contributions of employees, and
- The aggregate amount of elective contributions with respect to each employee for the calendar year is limited to $6,000.

The $6,000 contribution limit is adjusted annually for inflation.

**Catch-up contributions.** For employees who have attained the age of 50 or more, the $6,000 limitation is increased by the IRA catch-up amount (currently set at $1,000 for tax year 2023, which will be indexed for inflation beginning with the 2024 calendar year).

**Eligible employer.** An eligible employer is any employer that does not maintain any other qualified plan.

**403(b) plans.** The new law also creates a safe harbor deferral-only plan for employers with no retirement plan under the IRC section 403(b) annuity contract provisions. These rules generally mirror the same provisions that apply to starter 401(k) deferral-only arrangements.

**Top-heavy plans.** Both starter 401(k) deferral-only arrangements and safe harbor deferral-only plans are not treated as top-heavy plans under IRC section 416(g)(4).

## Coverage for Part-Time Workers

IRC section 410(a) provides minimum participation standards for all qualified retirement plans. In general, a plan cannot require as a condition of participation that an employee complete a period of service with the employer beyond the later of:

1) The date on which the employee attains the age of 21, or
2) The date on which the employee completes one year of service.

One year of service is defined as a 12-month period in which the employee has not less than 1,000 hours of service.

These are minimum standards. An employer, for example, can choose a lower number of hours of service requirement for employees eligible to participate in the plan.

**New law.** For plan years beginning after December 31, 2024, a pension plan that allows for elective deferrals [401(k) and 403(b) plans] cannot require as a condition of participation that an employee complete a period of service with the employer beyond the close of the earlier of:

1) The requirement that the employee be at least age 21 with one year of service (1,000 hours), or
2) The first 24-month period:
   a) Consisting of two consecutive 12-month periods during each of which the employee has at least 500 hours of service, and
   b) By the close of which the employee attains age 21.

An exception applies for certain union employees and nonresident aliens who receive no earned income from sources within the United States. 403(b) plans are not required to make non-elective or matching contributions on behalf of such employees even if such contributions are made on behalf of other employees eligible to participate in the plan.

Under the SECURE Act of 2019, this part-time provision was included under IRC section 401(k)(2)(D)(ii) [for 401(k) plans] except that it was for three consecutive 12-month periods during each of which the employee has at least 500 hours of service. The SECURE 2.0 Act of 2022 reduces this to two consecutive 12-month periods, effective as if it was included in the SECURE Act of 2019.

## Distributions From Long-Term Qualified Tuition Programs to Roth IRAs [IRC §529(c)]

In general, contributions to a qualified tuition program (QTP) are not deductible. Earnings accumulate tax free. Distributions are not taxable (including accumulated earnings) if the distributions are used for qualified higher education expenses.

**New law.** Effective for distributions after December 31, 2023, the new law allows for a special tax-free rollover to a Roth IRA from a long-term qualified tuition program. A long-term QTP is one that has been maintained for the 15-year period ending on the date of the distribution. The rollover distribution is tax free if:

1) It does not exceed the aggregate amount contributed to the program (and earnings attributable to the contributions) before the 5-year period ending on the date of the distribution, and
2) It is paid in a direct trustee-to-trustee transfer to a Roth IRA maintained for the benefit of the QTP designated beneficiary.

**Limitations.** The annual contribution limits to Roth IRAs applies to the QTP rollover distribution for that year. There is also a $35,000 lifetime aggregate limit for all QTP to Roth IRA rollover distributions.

**Treatment under Roth IRA rules.** Once the QTP is rolled over into a Roth IRA, it is treated as a qualified rollover contribution inside the Roth IRA under IRC section 408A(e).

**Author's Comment**

Thus, subsequent distributions from the Roth IRA are subject to the Roth IRA distribution rules and not the QTP distribution rules. For example, a designated beneficiary of a QTP who does not attend college or use all of the QTP funds for college can instead use the money to save for retirement in a Roth IRA.

## Emergency Savings Accounts Linked to Individual Account Plans

Employer defined contribution plans have restrictions as to when a participant is allowed to withdraw money from the plan. For example, a participant may not be allowed to withdraw money until separation from service, attaining a certain age, or death.

Qualified plans are allowed to let participants borrow from the plan for various hardship reasons. According to a report by the Federal Reserve, almost half of Americans would struggle to cover an unexpected $400 expense. The Congressional summary for the new law said a recent study found that in the past year, almost 60% of retirement account participants who lack emergency savings borrowed from their long-term retirement savings, compared to only 9% of those who had at least a month of emergency savings on hand.

Congress believes that separating emergency savings from one's retirement savings would provide participants with a better understanding that one account is for short-term emergency needs and the other is for long-term retirement savings.

**New law.** Effective for plan years beginning after December 31, 2023, the new law allows employers to set up emergency savings accounts that are designated Roth accounts linked to the employer's defined contribution plan. A pension-linked emergency savings account cannot have a minimum contribution or account balance requirement, and must allow participants to withdraw amounts at the discretion of the participant at least once per calendar month. The first four withdrawals from the account each plan year may not be subject to any fees or charges solely on the basis of such withdrawals.

The plan must separately account for contributions to the pension-linked emergency savings account of the individual account plan and any earnings allocable to such contributions. Withdrawals are subject to the rules that apply to elective deferrals as Roth contributions under IRC section 402A(e).

Contributions are limited so that the account balance of the pension-linked emergency savings account cannot exceed the lesser of $2,500, or the amount determined by the plan sponsor. The $2,500 amount is adjusted for inflation beginning after 2024. If the account balance exceeds the $2,500 limit (or the plan sponsor's limit), the participant can elect to have the excess contributed to another designated Roth account (subject to the designated Roth account rules).

The new law also has provisions to allow for automatic contributions to a pension-linked emergency savings account at a rate that is not more than 3% of compensation (up to the above account balance limits).

The new law also allows for employer matching contributions to a pension-linked emergency savings account at the same rate as any other matching contributions on account of an elective contribution by the participant. The employer matching contributions are also subject to the above account balance limits.

Upon termination of employment of the participant, or termination by the plan sponsor of the pension-linked emergency savings account, the participant must be allowed to transfer in whole or in part the account balance into another designated Roth account.

## Remove Required Minimum Distribution Barriers for Life Annuities [IRC §401(a)(9)(J)]

Effective for calendar years ending after December 29, 2022, the new law allows for the following increases in payments under a commercial annuity.

1) Annuity payments that increase by a constant percentage, applied not less frequently than annually, at a rate that is less than 5% per year,
2) A lump sum payment that:
   a) Results in a shortening of the payment period with respect to an annuity or a full or partial commutation of the future annuity payments, provided that such lump sum is determined using reasonable actuarial methods and assumptions, as determined in good faith by the issuer of the contract, or
   b) Accelerates the receipt of annuity payments that are scheduled to be received within the ensuing 12 months, regardless of whether such acceleration shortens the payment period with respect to the annuity, reduces the dollar amount of benefits to be

paid under the contract, or results in a suspension of annuity payments during the period being accelerated,

c) An amount which is in the nature of a dividend or similar distribution, provided that the issuer of the contract determines such amount using reasonable actuarial methods and assumptions, as determined in good faith by the issuer of the contract, when calculating the initial annuity payments and the issuer's experience with respect to those factors, or

d) A final payment upon death that does not exceed the excess of the total amount of the consideration paid for the annuity payments, less the aggregate amount of prior distributions or payments from or under the contract.

## Eliminating a Penalty on Partial Annuitization

If a tax-preferred retirement account also holds an annuity, current law requires that the account be bifurcated between the portion of the account holding the annuity and the rest of the account for purposes of applying the required minimum distribution rules. This treatment may result in higher minimum distributions than would have been required if the account did not hold an annuity.

**New law.** Effective on December 29, 2022, the new law directs the IRS to update relevant regulations to permit the account owner to elect to aggregate distributions from both portions of the account for purposes of determining minimum distributions.

## Recovery of Retirement Plan Overpayments (IRC §414)

Sometimes retirees mistakenly receive more money than they are owed under their retirement plans. These mistakes cause problems when they occur over time, and plan fiduciaries later seek to recover the overpayments from unsuspecting retirees. When an overpayment has lasted for years, plans often compel retirees to repay the amount of the overpayment, plus interest, which can be substantial. Even small overpayment amounts can create a hardship for a retiree living on a fixed income.

**New law.** Effective December 29, 2022, the new law allows retirement plan fiduciaries the latitude to decide not to recoup overpayments that were mistakenly made to retirees. If plan fiduciaries choose to recoup overpayments, limitations and protections apply to safeguard innocent retirees. This protects both the benefits of future retirees and the benefits of current retirees. Rollovers of the overpayments also remain valid. The new law further outlines how plan fiduciaries may proceed with respect to determinations made prior to December 29, 2022 to seek or not to seek recovery of overpayments.

## Reduction in Excise Tax on Certain Accumulations in Qualified Retirement Plans [IRC §4974(a)]

If the amount distributed during the year under a qualified retirement plan is less than the required minimum distribution (RMD) for the year, the participant (the payee) is subject to an excise tax equal to 50% of the RMD that was not distributed during the year. The 50% excise tax can be waived if the shortfall was due to reasonable cause, and reasonable steps are being taken to remedy the shortfall.

**New law.** Effective for tax years beginning after December 29, 2022, the 50% excise tax is reduced to 25%.

The 25% excise tax is further reduced to 10% if the taxpayer corrects the shortfall by submitting a return during the correction window reflecting such tax. The correction window means the period of time beginning on the date on which the tax is imposed with respect to a shortfall and ending on the earliest of:
- The date of mailing a notice of deficiency with respect to the excise tax,
- The date on which the tax imposed is assessed, or
- The last day of the second tax year that begins after the end of the tax year in which such tax is imposed.

**Author's Comment**

The new law does not amend the waiver of the tax for reasonable cause under IRC section 4974(d), which still applies. Thus, the 10% rate described above applies when there was not a reasonable cause for the error, but the taxpayer submits a return and pays the excise tax within the correction window. In most cases, tax practitioners should continue to help clients avoid the penalty altogether under the reasonable cause rules.

## Dollar Limit for Mandatory Distributions [IRC §401(a)(31]

Under IRC section 401(a)(31), a qualified retirement plan must allow for a direct trustee-to-trustee transfer of an eligible rollover distribution. IRC section 401(a)(31)(B) allows employers to transfer former employee's retirement accounts from their employer plan into an IRA on behalf of the former employee if their balances are between $1,000 and $5,000.

**New law.** Effective for distributions made after December 31, 2023, the $5,000 amount described above is increased to $7,000.

## First Day of the Month Requirement for Governmental Section 457(b) Plans [IRC §457(b)]

Participants in a governmental 457(b) plan must request changes in their deferral rate prior to the beginning of the month in which the deferral will be made. This rule does not exist for other types of defined contribution plans.

**New law.** Effective for tax years beginning after December 29, 2022, participants can request changes in their deferral rate at any time prior to the date that the compensation being deferred is available.

## Qualified Charitable Distributions [IRC §408(d)]

Taxpayers can elect to make a qualified charitable distribution (QCD) from an IRA to an eligible charitable organization. The distribution is treated as a nontaxable distribution and the contribution to the charitable organization is not deductible. The taxpayer must be at least age 70½, and the QCD is limited to $100,000 per year. The QCD must be transferred directly from the IRA to the charity. Not all charities are eligible.

**New law.** Effective for tax years ending after December 29, 2022, taxpayers can make a one-time up to $50,000 QCD to a split-interest entity (charitable gift annuity, charitable remainder unitrust, and charitable remainder annuity trust).

**Increase in QCD limitation.** Effective for tax years beginning after 2023, the $100,000 QCD limitation amount is adjusted annually for inflation.

## Distributions to Firefighters [IRC §72(t)]

IRC section 72(t) imposes a 10% penalty tax (in addition to the regular tax) on the early distribution from a qualified retirement plan. An early distribution is generally a distribution made before the participant attains the age of 59½. IRC section 72(t) includes a number of exceptions to the 10% early withdrawal penalty.

One exception is for employees who separate from service after attainment of age 55. If the employee is a qualified public safety employee in a governmental plan, the 10% penalty does not apply if such employee separates from service after attainment of age 50. The age 50 exception applies to public sector employees (such as public sector firefighters), but not private sector employees.

**New law.** Effective for distributions made after December 29, 2022, the 10% early withdrawal penalty does not apply to distributions to private sector firefights who have separated from service after attainment of age 50.

## Exclusion of Certain Disability-Related First Responder Retirement Payments (IRC §139C)

Effective for tax years beginning after December 31, 2026, a new exclusion from gross income applies for qualified first responders who receive retirement payments. The amount of the retirement payment that does not exceed the annualized excludable disability amount is excluded from gross income. Qualified first responder service means service as a law enforcement officer, firefighter, paramedic, or emergency medical technician.

## Top Heavy Rules for Defined Contribution Plans [IRC §416(c)]

Qualified retirement plans must pass the top-heavy test, in addition to other nondiscrimination tests. Plans that are deemed top-heavy are required to provide employees with a minimum of a 3% of pay non-elective contribution. Other nondiscrimination tests that apply to 401(k) plans allow an employer to test otherwise excludable employees (e.g., those who are under age 21 and have less than one year of service) separately. This was intended to encourage plan sponsors to permit employees to defer earlier than the minimum age and service conditions permitted under the law because it reduces the situations where plans would fail the nondiscrimination tests if these employees were included when performing the test. However, this separate testing is not allowed for the top-heavy test. Small business retirement plans often do not cover excludable employees because, if the plan is or becomes top heavy, the employer may be required to contribute a top-heavy employer contribution for all employees who are eligible to participate in the plan.

 

**New law.** Effective for plan years beginning after December 31, 2023, the new law allows an employer to perform the top-heavy test separately on the non-excludable and excludable employees. This is intended to remove the financial incentive to exclude employees from the 401(k) plan and increase retirement plan coverage to more workers.

## Repayment of Qualified Birth or Adoption Distribution Limited to Three Years [IRC §72(t)]

The SECURE Act of 2019 allowed for penalty-free withdrawals from retirement plans for individuals in case of a qualified birth or adoption of a child. The aggregate amount which may be treated as a qualified birth or adoption distribution cannot exceed $5,000.

The law allowed for such a distribution to be recontributed to a retirement plan at any time and treat it as a tax-free rollover. The problem is that a taxpayer generally has three years to amend a return. Thus, there is no mechanism under the law allowing someone who takes a birth or adoption distribution to recontribute the distribution more than three years later and amend their return to receive a refund for the taxes that were paid in the distribution year.

**New law.** Effective for distributions made after December 29, 2022, a taxpayer has three years from the date of distribution to recontribute it as a rollover back into a retirement plan. A temporary rule applies to distributions made on or before December 29, 2022. Such distributions can be recontributed if made before January 1, 2026.

## Individual Retirement Plan Statue of Limitations for Excise Tax on Excess Contributions and Certain Accumulations (IRC §6501)

Under prior law, the statute of limitations for excise taxes imposed on excess contributions, or required minimum distribution failures start running as of the date that a specific excise tax return (Form 5329) is filed for the violation. Individuals often are not aware of the requirement to file Form 5329, and this can lead to an indefinite period of limitations that can cause hardship for taxpayers due to the accumulation of interest and penalties.

**New law.** Effective December 29, 2022, the 3-year statute of limitations begins when the taxpayer files an individual tax return (Form 1040) for the year the individual failed to take a required minimum distribution. The statute of limitations is increased to six years in the case of an excess contribution.

If an individual is otherwise not required to file a return, the 3-year statute of limitations begins on the date the return would have been required to be filed (excluding any extensions).

The 3-year/6-year statute of limitations under this new law does not apply to property acquired for less than fair market value (excise tax under IRC section 4973 on a bargain sale to an IRA).

## Penalty-Free Withdrawal From Retirement Plans for Individual in Case of Domestic Abuse [IRC §72(t)(2)(K)]

IRC section 72(t) imposes a 10% penalty tax (in addition to the regular tax) on the early distribution from a qualified retirement plan. An early distribution is generally a distribution made before the participant attains the age of 59½. IRC section 72(t) includes a number of exceptions to the 10% early withdrawal penalty.

**New law.** Effective for distributions made after December 31, 2023, the new law allows for a penalty-free withdrawal from a retirement plan to a domestic abuse victim. The aggregate amount which may be treated as an eligible distribution to a domestic abuse victim cannot exceed an amount equal to the lesser of:

- $10,000, or
- 50% of the present value of the non-forfeitable accrued benefit of the employee under the plan.

The $10,000 amount is indexed for inflation after calendar year 2024.

A distribution is treated as an eligible distribution to a domestic abuse victim if such distribution is from an applicable eligible retirement plan and is made during the 1-year period beginning on the date the individual is a victim of domestic abuse by a spouse or domestic partner.

Domestic abuse means physical, psychological, sexual, emotional, or economic abuse, including efforts to control, isolate, humiliate, or intimidate the victim, or to undermine the victim's ability to reason independently, including by means of abuse of the victim's child or another family member living in the household.

The distribution can be repaid within three years of the distribution. The repayment then turns the distribution into a tax-free rollover distribution (in which case the taxpayer can file an amended return to claim a refund on taxes that were paid on the distribution).

An applicable eligible retirement plan is any of the following.

- IRA.
- Individual retirement annuity.
- Qualified trust.
- 403(a) annuity plan.
- Qualified annuity plan.
- 457(b) deferred compensation plan.
- 403(b) annuity contract.

An applicable eligible retirement plan does not include a defined benefit plan or a joint and survivor annuity.

The withholding rules for distributions from qualified retirement plans do not apply to domestic abuse victim eligible distributions.

The plan administrator can rely on the self-certification of the domestic abuse victim that the distribution qualifies as an eligible distribution.

## Plan Amendments Made by Employer Tax Return Due Date

Employers are allowed to adopt a new retirement plan by the due date of the employer's tax return for the fiscal year in which the plan is effective. The law, however, provides that plan amendments to an existing plan must generally be adopted by the last day of the plan year in which the amendment is effective. This precludes an employer from adding plan provisions that may be beneficial to participants.

**New law.** Effective for plan years beginning after December 31, 2023, the new law amends these provisions to allow discretionary amendments that increase participants' benefits to be adopted by the due date of the employer's tax return.

## Retroactive First Year Elective Deferrals for Sole Proprietors [IRC §401(b)]

An employer may establish a new 401(k) plan after the end of the tax year, but before the employer's tax filing date and treat the plan as having been established on the last day of the tax year. Such plans may be funded by employer contributions up to the employer's tax filing date.

**New law.** Effective for plan years beginning after December 29, 2022, the new law allows these plans, when they are sponsored by sole proprietors or single-member LLCs (with no other employees of the business), to receive employee contributions up to the due date (without extension) for filing of the individual's tax return for the initial year.

## Tax Treatment of IRA Involved in a Prohibited Transaction [IRC §408(e)]

When an individual engages in a prohibited transaction with respect to their IRA, the IRA is disqualified and treated as distributed to the individual, irrespective of the size of the prohibited transaction.

**New law.** Effective for tax years beginning after December 29, 2022, the new law clarifies that if an individual has multiple IRAs, only the IRA with respect to which the prohibited transaction occurred will be disqualified.

## Clarification of Substantially Equal Periodic Payment Rule [IRC §72(t)]

IRC section 72(t) imposes a 10% penalty tax (in addition to the regular tax) on the early distribution from a qualified retirement plan. An early distribution is generally a distribution made before the participant attains the age of 59½. IRC section 72(t) includes a number of exceptions to the 10% early withdrawal penalty.

One exception applies to substantially equal periodic payments that are made over the account owner's life expectancy.

**New law.** The new law provides that this exception continues to apply in the case of a rollover of the account, and exchange of an annuity providing the payments, or an annuity that satisfies the required minimum distribution rules.

## Roth Plan Distribution Rules (IRC §402A)

Required minimum distributions are not required to begin prior to the death of the owner of a Roth IRA. However, pre-death distributions are required in the case of the owner of a Roth designated account in an employer retirement plan [for example, a Roth 401(k) plan].

**New law.** Effective for tax years beginning after December 31, 2023, the mandatory distribution rules do not apply before death of a participant in a designated Roth account in an employer plan. A transition rule says that the new law does not apply to distributions which are required for years beginning before January 1, 2024, but are permitted to be paid on or after that date.

## Exception to Penalty on Early Distributions From Qualified Plans for Individuals With a Terminal Illness [IRC §72(t)(L)]

IRC section 72(t) imposes a 10% penalty tax (in addition to the regular tax) on the early distribution from a qualified retirement plan. An early distribution is generally a distribution made before the participant attains the age of 59½. IRC section 72(t) includes a number of exceptions to the 10% early withdrawal penalty.

**New law.** Effective for distributions made after December 29, 2022, the 10% penalty does not apply to distributions which are made to the employee who is a terminally ill individual on or after the date on which such employee has been certified by a physician as having a terminal illness.

A terminally ill individual means an individual who has an illness or physical condition which can reasonably expect to result in death in 84 months or less after the date of the physician's certification.

The individual can repay the distribution within three years and treat the distribution as a tax-free rollover distribution.

## Surviving Spouse Election to be Treated as Employee [IRC §401(a)(9)(B)(iv)]

Effective for calendar years beginning after December 31, 2023, if a designated beneficiary of a retirement plan is the surviving spouse of the employee, the surviving spouse can elect to be treated as the employee. Under such an election, the date on which the requirement minimum distributions (RMDs) must begin is no earlier than the date on which the employee would have attained the applicable age to begin receiving RMDs. If the surviving spouse dies before such distributions begin, these rules apply as if the surviving spouse is the employee.

**Author's Comment**

This rule basically applied before the new law, except the new law adds the election provision. Prior law did not provide for a surviving spouse to elect to be treated as the employee. The new law also replaces the age 72 RMD beginning date with "applicable age," since the age 72 RMD beginning date goes up to age 73 starting in 2023 and age 75 starting in 2033.

## Repeal of Direct Payment Requirement on Exclusion From Gross Income of Distributions From Governmental Plans for Health and Long-Term Care Insurance [IRC §402(l)]

An exclusion from gross income ($3,000) is allowed for a distribution from a governmental retirement plan to a public safety officer to pay for their health insurance premiums. The exclusion requires that the plan directly pay the insurance premiums.

**New law.** Effective for distributions made after December 29, 2022, the new law repeals the direct payment requirement.

## Qualified Public Safety Employee Exemption From Early Withdrawal Penalty [IRC §72(t)]

IRC section 72(t) imposes a 10% penalty tax (in addition to the regular tax) on the early distribution from a qualified retirement plan. An early distribution is generally a distribution made before the participant attains the age of 59½. IRC section 72(t) includes a number of exceptions to the 10% early withdrawal penalty.

One exception is for employees who separate from service after attainment of age 55. If the employee is a qualified public safety employee, the 10% penalty does not apply if such employee separates from service after attainment of age 50.

A qualified public safety employee is defined as any employee of a state or political subdivision of a state who provides police protection, firefighting services, or emergency medical services, or any federal law enforcement officer, federal customs and border protection officer, federal firefighter, air traffic controller, nuclear materials courier, member of the U.S. Capital Police, member of the Supreme Court Police, or any diplomatic security special agent of the Department of State.

**New law.** Effective for distributions made after December 29, 2022, the "age 50" rule for qualified public safety employees is replaced with "age 50 or 25 years of service under the plan, whichever is earlier."

The new law also adds services as a corrections officer or as a forensic security employee providing for the care, custody, and control of forensic patients to the list of qualified public safety employees.

## Use of Retirement Funds in Connection With Qualified Federally Declared Disasters [IRC §72(t)]

Over the years, a number of disaster tax relief provisions applied to specific disasters from hurricanes, storms, floods, and wildfires. Most recently, they applied to the COVID-19 disaster. The Consolidated Appropriations Act, 2021 extended these provisions to apply to all federally-declared disasters that occurred during the period that began on December 28, 2019 and ended on December 27, 2020.

**New law.** The new law permanently extends the disaster tax relief provisions for retirement plans to apply to all federally-declared disasters that occur after December 27, 2020. The disaster tax relief provisions for retirement plans include the following.

**10% early withdrawal penalty exception.** The 10% early withdrawal penalty under IRC section 72(t) does not apply to a qualified disaster recovery distribution, which is defined as any distribution made:
- On or after the first day of the incident period of a qualified disaster and before the date that is 180 days after the applicable date with respect to such disaster, and
- To an individual whose principal place of abode at any time during the incident period of the qualified disaster is located in the qualified disaster area and who has sustained an economic loss by reason of the disaster.

A qualified disaster recovery distribution is limited to $22,000. The $22,000 amount is not indexed for inflation. However, the new law directs the Comptroller General of the U.S. to submit a report to Congress that addresses whether the $22,000 threshold on distributions provides adequate relief for taxpayers who suffer from a disaster.

**Repayment of distribution.** A qualified disaster recovery distribution may be repaid within the 3-year period beginning on the day after the date the distribution was received. Any amount repaid (up to the amount of the distribution) is treated as a tax-free rollover contribution (or tax free direct trustee to trustee transfer).

The qualified disaster recovery distribution rules apply to both IRAs and eligible employer retirement plans.

**3-year inclusion of distribution.** If the taxpayer does not repay the qualified disaster recovery distribution, the income inclusion is spread over the 3-tax year period beginning with the year of distribution. A taxpayer can elect not to have this provision apply and instead include the entire distribution in income in the year of distribution.

**Author's Comment**

This election may be applicable in cases where the taxpayer's income is otherwise low in the year of the disaster in comparison to subsequent years.

A qualified disaster recovery distribution is not subject to the mandatory withholding rules that apply to distributions from qualified employer plans.

**Recontributions of withdrawals for home purchases.** Any individual who received a qualified distribution may, during the applicable period, make one or more contributions in an aggregate amount not to exceed the amount of the qualified distribution to an eligible retirement plan and treat the distribution as a tax-free rollover distribution.

A qualified distribution means any distribution:
- Which is a qualified first-time homebuyer distribution,
- Which was to be used to purchase or construct a principal residence in a qualified disaster area, but which was not so used on account of the qualified disaster, and
- Which was received during the period beginning on the date which is 180 days before the first day of the incident period of the qualified disaster and ending on the date which is 30 days after the last day of the incident period.

The applicable period for recontribution of the withdrawal begins on the first day of the incident period of the qualified disaster and ends on the date which is 180 days after the applicable date of the disaster.

A similar set of rules applies to distributions for the purchase or construction of a principal residence in a qualified disaster area, but which was not so used on account of the qualified disaster. This set of rules is the same as the above rules for qualified first-time homebuyer distributions, except that it does not say the distribution has to be a qualified first-time homebuyer distribution.

**Loans from qualified plans.** Loans from qualified retirement plans are generally limited to the lesser of $50,000 or 50% of the present value (but not less than $10,000) of the taxpayer's vested benefit under the plan. Loans generally must be repaid within five years.

For individuals whose principal place of abode during the incident period of a qualified disaster is located in the qualified disaster area, and who has sustained an economic loss by reason of the disaster, then the $50,000 loan limit is increased to $100,000, and the 50% present value limit is increased to 100%.

Any loan repayment is delayed for one year for any payment with a due date beginning on the first day of the incident period of the qualified disaster and ending on the date which is 180 days after the last day of the incident period. Any subsequent repayments may be appropriately adjusted to reflect the delay in the due date. Also, the 5-year repayment of the loan period may be disregarded when these delay provisions apply.

## Employers Allowed to Replace SIMPLE Retirement Accounts With Safe Harbor 401(k) Plans [IRC §408(p)(11)]

Effective for plan years beginning after December 31, 2023, an employer may elect at any time during a plan year to terminate a SIMPLE retirement plan and replace it with a safe harbor 401(k) plan. The aggregate elective contributions of the employee under the terminated SIMPLE plan during its last plan year and under the safe harbor 401(k) plan during its transition year cannot exceed the sum of:

1) The SIMPLE elective deferral limit determined on a full-year basis multiplied by a fraction equal to the number of days in the plan year divided by 365, and
2) The 401(k) elective deferral limit determined on a full-year basis multiplied by a fraction equal to the number of days in the transition year divided by 365.

Funds in a SIMPLE plan must generally remain in the SIMPLE plan for at least two years from the date the employee first participated in the plan before they can be rolled over into any other type of retirement plan. This 2-year rule is waived in the case of an employer who elects to replace the SIMPLE plan with a Safe Harbor 401(k) plan.

## Elimination of Additional Tax on Corrective Distributions of Excess Contributions [IRC §72(t)]

IRC section 72(t) imposes a 10% penalty tax (in addition to the regular tax) on the early distribution from a qualified retirement plan. An early distribution is generally a distribution made before the participant attains the age of 59½. IRC section 72(t) includes a number of exceptions to the 10% early withdrawal penalty.

The law requires a distribution if too much is contributed to an IRA. The corrective distribution includes the excessive contribution and any earnings allocable to that contribution.

**New law.** The new law exempts the excess contribution and earnings allocable to the excess contribution from the 10% penalty tax on early distributions, and is effective for any determination of, or affecting liability for taxes, interest, or penalties which is made on or after December 29, 2022, without regard to whether the act (or failure to act) upon which the determination is based occurred before December 29, 2022.

## Long-Term Care Contracts Purchased With Retirement Plan Distributions [IRC §401(a)(39)]

IRC section 72(t) imposes a 10% penalty tax (in addition to the regular tax) on the early distribution from a qualified retirement plan. An early distribution is generally a distribution made before the participant attains the age of 59½. IRC section 72(t) includes a number of exceptions to the 10% early withdrawal penalty.

**New law.** Effective for distributions made after December 29, 2025 (three years after the date of enactment), the new law permits retirement plans to distribute up to $2,500 per year for the payment of premiums for certain specified long term care insurance contracts. Distributions from plans to pay such premiums are exempt from the 10% penalty tax on early distributions. Only a policy that provides for high quality coverage is eligible for early distribution and waiver of the 10% penalty tax.

**Qualified long-term care distribution.** A qualified long-term care distribution means the aggregate distributions during the year equal to the lesser of:

1) The amount paid during the year for certified long-term care insurance for the employee, spouse, or other family members.
2) The amount equal to 10% of the present value of the non-forfeitable accrued benefit of the employee under the plan.
3) $2,5000.

The $2,500 amount is indexed annually for inflation.

The law requires that the employee receives a long-term care premium statement provided by the issuer of the long-term care coverage upon the request of the owner of the coverage.

If the long-term care distribution relates to the spouse of the employee, the 10% penalty exception only applies if the employee and the spouse file a joint return.

A qualified long-term care distribution is not subject to the mandatory withholding rules for eligible rollover distributions.

The new law creates new IRC section 6050Z which describes the reporting requirements for issuers of certified long-term care insurance.

## Modification of Required Minimum Distribution Rules for Special Needs Trusts [IRC §401(a)]

The SECURE Act of 2019 placed limits on the ability of beneficiaries of defined contribution retirement plans and IRAs to receive lifetime distributions after the account owner's death. Special rules apply in the case of certain beneficiaries, such as those with a disability.

**New law.** Effective for calendar years beginning in 2023, the new law clarifies that in the case of a special needs trust established for a beneficiary with a disability, the trust may provide for a charitable organization as the remainder beneficiary.

## Annual Audits for Group of Plans

In general, a Form 5500 for a defined contribution plan must contain an opinion from an independent qualified public accountant as to whether the plan's financial statements and schedules are fairly presented. However, no such opinion is required with respect to a plan covering fewer than 100 participants.

**New law.** Effective December 29, 2022, the new law clarifies that plans filing under a Group of Plans need only to submit an audit opinion if each individual plan has 100 participants or more.

## Safe Harbor for Corrections of Employee Elective Deferral Failures [IRC §414(cc)]

Employers that adopt a retirement plan with automatic enrollment and automatic escalation features could be subject to significant penalties if even honest mistakes are made. The Internal Revenue Service has issued guidance on the correction of failures relating to default enrollment of employees into retirement plans. This guidance includes a safe harbor, which is scheduled to expire on December 31, 2023, that permits correction if notice is given to the affected employee, correct deferrals commence within certain specified time periods, and the employer provides the employee with any matching contributions that would have been made if the failure had not occurred.

**New law.** Effective for errors made after December 31, 2023, the new law allows for a grace period to correct, without penalty, reasonable errors in administering these automatic enrollment and automatic escalation features. Errors must be corrected prior to 9½ months after the end of the plan year in which the mistakes were made.

## SIMPLE and SEP Roth IRAs [IRC §408A]

Under prior law, SIMPLE IRAs and SEPs cannot contain a Roth contribution option.

**New law.** Effective for tax years beginning after December 31, 2022, SIMPLE IRAs can also accept Roth contributions. SEP plans which previously only accepted employer money can allow employees the ability to treat employee and employer SEP contributions as Roth contributions (in whole or in part). Grandfathered salaried reduction SEPs cannot accept Roth contributions.

A plan which is designated as a Roth IRA cannot be treated as a SEP or a SIMPLE plan unless the employee elects for the plan to be so treated.

## Hardship Withdrawal Rules for 403(b) Plans [IRC §403(b)]

Employer plans generally do not allow for withdrawals unless the employee separates from service, reaches a specified age, or due to death of the employee. A plan can also allow for withdrawals in the case of certain hardships.

The hardship distribution rules for 401(k) and 403(b) plans are different in certain ways. For example, for 401(k) plans, all amounts are available for a hardship distribution. For 403(b) plans, in some cases, only employee contributions (without earnings) are available for hardship distributions.

**New law.** Effective for plan years beginning after December 31, 2023, the new law conforms the 403(b) rules to the 401(k) rules.

## Catch-up Elective Deferrals Required to be Designated Roth Contributions for High Income Employees [IRC §414(v)(7)]

Under prior law, catch-up contributions to a qualified retirement plan [for example, a 401(k) or 403(b) plan] for participants age 50 or older can be made on a pre-tax or Roth basis (if a Roth option is permitted by the plan sponsor).

**New law.** Effective for tax years beginning after December 31, 2023, participants whose wages for the preceding calendar year exceed $145,000 can only make catch-up elective deferrals as designated Roth contributions. If the plan does not provide for a designated Roth option, then participants with wages exceeding $145,000 cannot make additional catch-up elective deferrals.

This rule does not apply to SEPs or SIMPLE plans.

The $145,000 threshold is indexed for inflation after 2024.

## Optional Treatment of Employer Matching or Non-Elective Contributions as Roth Contributions [IRC §402A(a)]

Plan sponsors are not permitted to provide employer matching contributions in their 401(k), 403(b), and governmental 457(b) plans on a Roth basis. Matching contributions must be on a pre-tax basis only.

**New law.** Effective December 29, 2022, the new law allows defined contribution plans to provide participants with the option of receiving employer matching contributions on the employee's behalf as a Roth contributions. Any designated Roth contribution made by the employer on the employee's behalf must be non-forfeitable. Roth contributions are not excludable from gross income.

The term matching contribution means:
- Any employer contribution made to a defined contribution plan on behalf of an employee on account of an employee contribution made by the employee or on account of an employee's elective deferral, and
- Any contribution to an eligible deferred compensation plan under IRC section 457(b) by an eligible employer on behalf of an employee and on account of the employee's elective deferral.

## Charitable Conservation Easements [IRC §170(h)]

The tax deduction for charitable contributions of conservation easements has long played a crucial role in incentivizing the preservation of critical habitat, open spaces, and historically important areas and structures. However, since 2016, the IRS has identified certain syndicated conservation easement transactions involving pass-through entities as "listed transactions" carrying a high potential for abusive tax avoidance.

**New law.** Effective for contributions made after December 29, 2022, the new law disallows a charitable deduction for a qualified conservation contribution if the deduction claimed exceeds two and one half times the sum of each partner's relevant basis in the contributing partnership, unless the contribution meets a 3-year holding period test, substantially all of the contributing partnership is owned by members of a family, or the contribution relates to the preservation of a certified historic structure. In the case of a contribution for the preservation of a certified historic structure, a new reporting requirement applies. The new law also provides taxpayers the opportunity to correct certain defects in an easement deed (excluding easements involved in abusive transactions) and makes certain changes to statute of limitations and penalty provisions.

## Retiree Health Benefits in Pension Plans [IRC §420(b)]

An employer may use assets from an overfunded pension plan to pay retiree health and life insurance benefits. These rules were scheduled to sunset at the end of 2025.

**New law.** Effective for transfers made on or after December 29, 2022, the new law extends the sunset date to the end of 2032 and permits transfers to pay retiree health and life insurance benefits provided the transfer is no more than 1.75% of plan assets and the plan is at least 110% funded.

## Other Provisions

- The new law clarifies that a pooled employer plan may designate a named fiduciary (other than an employer in the plan) to collect contributions to the plan.
- The new law directs the IRS to provide each state assistance in locating owners of applicable matured and unredeemed savings bonds. The state is then permitted to use information from the IRS to locate the registered owner in accordance with the state's standards for recovery of abandoned property.
- The new law modifies and updates the employee stock ownership plan (ESOP) rules relating to publically traded securities. Certain non-exchange traded securities can now qualify as publicly traded employer securities for purposes of the ESOP rules.
- The new law increases the age requirement by which blindness or disability must occur for an individual to be eligible for a qualified ABLE programs, from age 26 to age 46, effective for tax years beginning after 2025.
- The new law permits 403(b) custodial accounts to participate in group trusts with other tax-preferred savings plans and IRAs.
- The new law amends the rules for qualifying longevity annuity contracts (QLACs) by repealing the 25% limit and allowing up to $200,000 to be used from an account balance to purchase a QLAC.

 

- The new law directs the IRS to update and amend the regulations on insurance dedicated exchange-traded funds to be available through individual variable annuities.
- The new law directs the IRS to create a national online searchable lost and found database for Americans' retirement plans, enabling participants who have lost track of their retirement plans to search for the contact information of their plan administrator.
- The new law allows retirement plan administrators to correct more types of errors internally through self-correction, correct inadvertent IRA errors, and exempt certain failures to make required minimum distributions from the otherwise applicable excise tax.
- The new law allows employees to self-certify that they have had an event that constitutes a hardship for purposes of taking a hardship withdrawal from their retirement plan.
- The new law reforms the family attribution rules for purposes of the nondiscrimination tests for retirement plans. The law modifies the rules in cases where spouses with separate businesses reside in a community property state, and the attribution of stock between parents and minor children.
- The new law directs the Labor Secretary to update performance benchmark regulations for asset allocation funds that are used as investments in retirement plans that include a mix of asset classes.
- The new law directs the IRS to review reporting and disclosure requirements for pension plans and report to Congress.
- The new law eliminates certain unnecessary notice requirements that were required to be provided to plan participants.
- The new law requires the department of labor to review the current interpretive bulletin governing pension risk transfers to determine whether amendments are warranted and to report to Congress its findings.
- The new law directs the IRS to simplify and standardize the rollover process by issuing sample forms for direct rollovers.
- The new law directs the IRS to amend the regulation relating to "Mortality Tables for Determining Present Value under Defined Benefit Pension Plans."
- The new law requires the Government Accountability Office to issue a report to Congress on the effectiveness of IRC section 402(f) notices.
- The new law requires defined contribution plans (unless the participant elects otherwise) to issue paper benefit statements at least once annually.
- The new law adds Tribal courts to the list of courts authorized under federal law to issue qualified domestic relations orders.
- The new law requires the Government Accountability Office to review its fiduciary disclosure requirement in participant-directed individual account plan regulations and submit a report to Congress.
- The new law allows for consolidation of defined contribution plan notices.
- The new law requires pension plan administrators to provide plan participants and retirees with critical information that would allow people considering what is best for their financial futures to compare between benefits offered under the plan and the lump sum, and would explain how the lump sum was calculated, the ramifications of accepting a lump sum, such as the loss of certain federal protections, details about the election period, where to follow up with questions, and other information.

- The new law requires that defined benefit annual funding notices identify issues more clearly on the plan's annual funding notice.
- The new law requires the Department of Labor Secretary to conduct a study on the new and growing pooled employer plan industry and report to Congress.
- The new law boosts employee ownership programs through the Department of Labor which may make grants to promote employee ownership through existing and new programs.
- The new law directs the Department of Labor Secretary to study the impact of inflation on retirement savings and submit a report to Congress.
- The new law clarifies the rules on prohibiting the back loading of benefit accruals, as they relate to hybrid plans that credit variable interest.
- The new law removes the "applicable dollar amount" language in the rules for determining the premium fund target for purposes of unfunded vested benefits and replaces it with a flat $52 for each $1,000 of unfunded vested benefits.
- The new law includes a number of technical and clerical amendments to the SECURE Act of 2019.
- The new law allows plan amendments made pursuant to the SECURE 2.0 Act of 2022 to be made on or before the last day of the first plan year beginning on or after January 1, 2025 (2027 in the case of governmental plans) as long as the plan operates in accordance with such amendments as of the effective date of a bill requirement or amendment.
- The new law has a number of retirement provisions relating to judges and special trial judges of the Tax Court.