Fiduciary Hot Topics

Q4 2023

SECURE Act 2.0 Update

- SECURE Act 2.0 is an important piece of legislation not just because of the potential relative significance of any single change, but also due to the sheer volume of changes - over 90 in all. As a result, it is easy to conceive of scenarios where some might be overlooked.
- The effective dates of these changes are gradual. Some were effective immediately upon enactment (December 29th, 2022), but most have taken effect in the following years. All the provisions will not be fully effective until 2027.
- Here are some highlights to bear in mind. A description of all the changes in the Act can be found in the Hot Topics for the first quarter of 2023.

Rule Mandating Catchups Must be on a Roth Basis for Certain High Paid Employees - Delayed for Two Years

- The IRS has delayed the effective date for the rule that employees whose annual compensation exceeds $145,000 (indexed annually) may make catch up contributions only on a Roth basis. The catch-up rule allows employees aged 50 and older to make deferrals and Roth contributions beyond the annual limit. The annual limit for this year is $22,500 and the catch-up limit is $7,500.
- This rule was scheduled to take effect January 1st of next year. The delay is for two years until January 1, 2026.
- There was increasing concern about implementation because most record keepers and payroll providers have yet to make the necessary enhancements to their systems to administer this rule.

The Act Upended EPCRS

- A significant change, largely overlooked, affects the IRS Employee Plans Compliance Resolution System (“EPCRS”). The requirement to submit a VCP filing is now eliminated for all but the most egregious errors. For Congress to step into this area is a little unusual as resolving errors committed by taxpayers has always been left to the IRS’s discretion. This change was effective on the date of enactment.

- If one looks back far enough, historically the IRS provided taxpayers the ability to self-correct errors without formally approaching the IRS. In the event of an audit of the taxpayer, the subject would suffer no adverse consequences so long as the correction of the error was completed before there was notice of an audit.
- EPCRS was a significant departure from this practice. It required plan sponsors to step forward and complete a filing informing the IRS of the correction of “significant” errors if the correction was not made within two years of discovery (increased to three years in 2021). The IRS adapted this program through a complex Revenue Procedure published in 2013 that ran to almost 200 pages.
- These filings were time-consuming and expensive as it was necessary to retain legal counsel, and they were sometimes precarious undertakings because it was not possible to ascertain if the IRS would accept the proposed method for correcting the error. Sponsors could submit filings anonymously, but the IRS ended this practice in 2021.
- No filing was required for “insignificant” errors, but there was never a precise definition of what constitutes an “insignificant” error. This had been a facts and circumstances test depending on factors such as number of participants affected, plan assets involved and the time it took to discover the error.
- Now, under the SECURE Act any error can be self-corrected if it can be considered an “eligible inadvertent failure.” This nomenclature suggests that this term may be liberally interpreted and applies to any error except the most egregious such as misappropriation of plan assets or a tax avoidance scheme.
- There is now no stated time period for self-correction. Even in the event of an audit, self-correction is permitted so long as the plan sponsor can demonstrate some effort was made to correct the error before the IRS identified it.

Another change to EPCRS - Missed Deferrals Safe Harbor for Plans with Auto Enrollment Now Permanent

- Under EPCRS, initially the method of correcting a common problem, the failure to implement employee deferral elections required plan sponsors to contribute an amount equal to 50 percent of missed deferrals, as well as 100 percent of any missed match.
- Recognizing this was a windfall for plan participants, the IRS backed off, reducing the amount that had to be contributed to 25 percent of missed deferrals in some circumstances and to zero if correction is made fairly quickly.
- For plans with auto enrollment, there is a safe harbor. The plan sponsor does not have to make up missed deferrals if the error is corrected within 9 ½ months after the end of the plan year in which the error occurred or, earlier, the date the employee notified the sponsor of the error. For some unknown reason, this safe harbor was set to expire at the end of this year. The Act makes the safe harbor permanent.

Collecting and Retaining Documents Establishing Hardship Events no Longer Necessary

- A major headache for plan sponsors has always been collecting the necessary documentation when approving hardship distributions. As of the date of enactment, this is no longer necessary.
- The hardship distribution rule is a long-standing exception to the rule prohibiting in-service distributions from 401(k) plans. In administering hardship distributions, plan sponsors had to collect and retain documentation necessary to establish the occurrence of the hardship event, the amount and the employee’s certification that he/she does not have sufficient resources to satisfy the need.
- Beginning this year, plan sponsors are no longer required to collect this documentation. Rather, they can rely on the participants “self-certification” that a hardship event has occurred, the amount, and that the participant has insufficient liquid assets to satisfy the need.

Mandatory Cash Out Limit is Increasing to $7,000

- Employees with small balances may be forced out on termination. This allows plans to avoid the expense of maintaining small accounts, potentially for many years. The cap on accounts that may be forced out increases from $5,000 to $7,000 in 2024.
- This is a long overdue as this cap has not increased since 1986.

In 2025, Auto Enrollment Will Be Mandatory for New Plans Established After December 29, 2022

- Beginning in 2025 an “eligible automatic contribution arrangement” (EACA) will be mandatory for all new plans. Employees must be auto enrolled at between three and 10 percent of compensation, with one percent per year auto escalation up to 10 percent.

- Although not effective until 2025, keep in mind that this requirement applies retroactively to all plans established after the date of enactment.

Provisions Allowing In-Service Emergency Withdrawals and Emergency Savings Accounts Take Effect Next Year

- A concern expressed by members of Congress in drafting the SECURE Act was the fact so many Americans have little, or no savings set aside for unanticipated emergencies. Two provisions kick in next year that give participants access to their plan accounts in the event of emergency.
- These provisions are optional and will require plan amendments. Additional guidance from the IRS is necessary regarding the details of how these provisions will work in practice. At present, most record keepers are still working on their systems to incorporate this optional plan design.
- In-service withdrawals for emergency expenses
    - permitted to cover financial needs related to personal or family emergencies
    - $1,000 Annual cap
    - may be repaid within three years
    - only one withdrawal during the three-year repayment period unless initial withdrawal is repaid
    - not subject to the 10% penalty on early distributions before age 59 ½
- Emergency Savings Accounts
    - the Act allows plan sponsors to add “emergency savings accounts”
    - there is a cap of $2,500 - sponsors may opt for a lower amount
    - contributions must be on a Roth basis
    - contributions count against the annual limit on deferrals/Roth contributions
    - employees may be auto enrolled into these accounts at up to three percent of compensation
    - no minimum threshold may be imposed for contributions or balances
    - contributions to these accounts are eligible for matching contributions
    - cannot be offered to highly compensated employees
    - it must be invested in principal-protected assets
    - participants must be allowed to make at least one withdrawal per month - no charge may be imposed for the first four withdrawals
    - Some plan sponsors that are considering these accounts have expressed concern that the benefit of these accounts is outweighed by the additional complexity in plan design and administration, and the communication challenges in explaining these accounts to participants.

IRA Catch Up Limit Will Be Indexed Beginning Next Year

- As is true of 401(k) plans, catch up contributions may be made to IRAs. However, the catch-up limit is much smaller, only $1,000 and is not indexed for inflation. Beginning next year this limit will be indexed.

For more information, visit [WEBSITE] or call [PHONE].

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